EBS Mortgage Finance
(A Public Unlimited Company)

Directors' Report and Financial Statements

Year Ended 31 December 2013

DIRECTORS' REPORT AND FINANCIAL STATEMENTS

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DIRECTORS AND OTHER INFORMATION

DIRECTORS	
Denis Holland	Independent Non-Executive Director and Chairman
William Cunningham	Independent Non-Executive Director
Fidelma Clarke	Group Non-Executive Director
Gerry Gaffney	Executive Director
Owen Purcell	Executive Director (Managing Director)
SECRETARY	Sarah McLaughlin
REGISTERED AUDITOR	Deloitte & Touche Chartered Accountants & Statutory Audit Firm Hardwicke House Hatch Street Dublin 2 Ireland
REGISTERED OFFICE	2 Burlington Road Dublin 4 Ireland
REGISTERED NUMBER	463791
BANKERS	EBS Limited 2 Burlington Road Dublin 4 Ireland BNP Paribas Ireland 5 George's Dock International Financial Services Centre Dublin 1 Ireland
COVERED ASSETS MONITOR	Mazars Harcourt Centre Block 3 Harcourt Road Dublin 2 Ireland

DIRECTORS' REPORT

The Directors present their report and audited accounts for the year ended 31 December 2013. A statement of Directors' responsibilities in relation to the financial statements appears on page 10.

ACTIVITIES OF THE COMPANY

EBS Mortgage Finance ('the Bank'), a public unlimited company, obtained an Irish banking licence under the Irish Central Bank Act, 1971 (as amended) and was registered as a designated mortgage credit institution under the Asset Covered Securities Act, 2001 on 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'). EBS 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 ('the Central Bank').

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 2011, EBS sold €8.3bn of residential loans to the Bank and in turn the Bank issued a series of covered bonds. The Bank did not purchase any loans from EBS since 2011. In 2012, the Bank sold a €0.4bn portfolio of retail buy-to-let loans, being part of the Group deleveraging of non core assets as committed to under the Financial Measures Programme in 2011.

During 2013, the Bank repurchased €500m of the Series 5 and the €75m Series 6 bonds held by EBS which were due to mature in December 2013. The Bank issued a new bond (Series 13) in November 2013 with a total nominal value of €225m which was subscribed for in full by EBS. The bonds were recognised on the Statement of Financial Position at a value of €224.9m representing the Day 1 fair value. At the end of 2013, the total nominal value of covered bonds issued was €2.8bn, of which €0.05bn (2012: €0.05bn) were subscribed for by external bondholders and the remainder were subscribed for in full by EBS.

The Bank's business activities are restricted, under the Asset Covered Securities Acts, to dealing in, and holding, mortgage credit assets and limited classes of other assets, engaging in activities connected with the financing and refinancing of such assets, entering into certain hedging contracts and engaging in other activities which are incidental to, or ancillary to, the above activities. In accordance with the Asset Covered Securities Acts, the Cover-Assets Monitor, Mazars monitors compliance with the Acts and reports independently to the Central Bank.

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

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.

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.

DIRECTORS' REPORT *(continued)*

CORPORATE GOVERNANCE

AIB Group is subject to the provisions of the Central Banks' Corporate Governance Code for Credit Institutions and Insurance Undertakings ("the Central Bank Code"), including compliance with requirements which specifically relate to 'major institutions', which imposes minimum core standards upon all credit institutions and insurance undertakings licensed or authorised by the Central Bank. AIB Groups' corporate governance practices also reflect Irish company law and, in relation to the UK businesses, UK company law, the Listing Rules of the Enterprise Securities Market of the Irish Stock Exchange, and certain provisions of the US Sarbanes Oxley Act of 2002. As a separately licensed credit institution, the Banks' corporate governance practices also reflect the relevant provisions of the Central Bank Code. The Bank has fully applied the principals of UK Corporate Governance Code.

Governance is exercised through the Board of Directors ('the Board') and a senior management team. The conditions of the Bank's Central Bank licence require that there should be a minimum of two Non-Executive Directors who are independent of the parent company. Throughout 2013, there were two independent Non-Executive Directors on the Board. The Board also included two Executive Directors, both of whom were directly involved in the operation of the Bank, and one other director who, while also an employee of AIB p.l.c. was deemed to be a Non-Executive Director by virtue of the role she fulfilled in areas of AIB Group unrelated to the operations of EBS Mortgage Finance.

RESULTS FOR THE YEAR ENDED 31 DECEMBER 2013

The Income Statement for the year ended 31 December 2013 and the Statement of Financial Position at that date are set out on pages 78 and 79.

The Bank reported a loss before taxation of €5m for year ended 31 December 2013 (2012: loss before taxation €90m). The reported loss is mainly attributable to higher provision for impairment losses of €129m in 2013 (2012: €94m) offset by an increase in net interest income and a reduction in other operating loss in 2013 to Nil (2012: €98m).

<u>Net Interest Income</u>
Net interest income is up €18m or 15%.

Net interest income was €138m (2012: €120m) for the year generating a net interest margin of 217bps (2012: 172bps).

Total interest income amounted to €275m in 2013 (2012: €322m). Interest income mainly comprises of interest income from mortgage assets of €251m (2012: €285m) which decreased by 12% from 2012. This is mainly due to a reduction in the loans and advances to customers over the year. Interest income also includes income derived as a result of amortisation of fair value discount on loans and advances to customers of €24m (2012: €37m).

Total interest expense amounted to €137m (2012: €202m). Interest expense consists of interest on inter-company funding from EBS of €26m (2012: €44m) which decreased mainly as a result of a lower market interest rates applying to the inter-company loan and lower average loan balance. Interest expense also includes interest on debt securities of €36m (2012: €76m) which decreased as a result of the lower market interest rates and lower average balances of debt securities in issue during the year. The other component of interest expense is amortisation of fair value discount on debt securities in issue of €75m (2012: €82m) which decreased in 2013 due to lower levels of bonds in issue.

DIRECTORS' REPORT *(continued)*

Net Trading Expense
Net trading expense is down €5m.
Net trading expense of €5m (2012: €10m) 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 and a reduction in average swap nominal value due to lower loans and advances to customers balance.

Other Operating Losses
Other operating losses are Nil, down by €98m compared with 2012.
Other operating losses in 2012 comprise the loss on sale of residential loans of €152m offset by profit on repurchase of securities of €54m.

Operating Expense
Operating expenses are up by €1m.
Operating expenses which comprise direct costs and a service fee charge from EBS amounting to €9m (2012: €8m). The increase of €1m is due to an increase in statutory regulatory fees payable to the Central Bank of Ireland.

Provision for impairment loss
The impairment provision charge in 2013 is €129m up from €94m in 2012.
Total provisions held at December 2013 amount to €381m (2012: €244m) of which €335m (2012: €200m) were specific and €46m (2012: €44m) were collective. This provided 6.0% coverage on total loans (2012: 3.7%).

Further analysis can be found in the Risk Management Report. The impairment charges on loans and advances to customers are detailed in note 8.

Loans and advances to customers
Loans and advances to customers as at 31 December 2013 amounted to €6.0bn (2012: €6.4bn). The decrease from 2012 is largely due to repayments received from customers and higher loan impairment provisions of €0.1bn.

Funding
The funding of the mortgage assets is in part through an inter-company loan facility from EBS shown under Deposits by Credit Institutions, which amounted to €3.0bn at 31 December 2013 (2012: €3.3bn).

Debt securities in issue
During the year the Bank re-purchased bonds with a nominal value of €575m from EBS.

In March 2013, the Bank partially redeemed two retained bonds (Series 5 & Series 6) in the amount of €75m each, leaving each bond with a remaining nominal of €425m. In October 2013, the remaining €425m nominal of the Series 5 was redeemed ahead of its' December 2013 maturity date.
The Bank issued a new bond in November 2013 with a nominal of €225m which was subscribed for in full by EBS.

As at 31 December 2013, the total nominal amount of principal outstanding in respect of mortgage covered securities was €2.8bn (2012: €3.2bn) of which €0.1bn (2012: €0.1bn) was held by third parties and €2.7bn (2012: €3.1bn) by EBS.

Share Capital
The share capital of the Bank consists of 551,540,000 €1 ordinary shares issued to EBS (2012: 476,540,000 €1 ordinary shares). On 20 December 2013 the bank issued 75,000,000 €1 ordinary shares at par which were subscribed for in full by EBS.

DIRECTORS' REPORT *(continued)*

Capital ratios
For 2013, the capital ratios are calculated in accordance with the Capital Requirements Directive.

	2013 **€m**	2012 €m
Core Tier 1 Capital	**422**	351
Non Core Tier 1 Capital	**-**	-
Tier 1 Capital	**422**	351
Tier 2 Capital	**40**	44
Total Capital	**462**	395
Risk Weighted Assets	**3,270**	3,538
Total Capital Ratio	**14.10%**	11.10%
Tier 1 Ratio	**12.87%**	9.90%
Core Tier 1 Ratio	**12.87%**	9.90%

At 31 December 2013 the total capital ratio was 14.10% (2012: 11.10%) and the tier 1 ratio was 12.87% (2012: 9.90%). Both of these are above Regulatory Capital minimum. Further information in relation to Regulatory Capital is set out in note 16.

BUSINESS REVIEW AND FUTURE DEVELOPMENTS

The sale of residential mortgages 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 peripheral European covered bond jurisdictions improved consistently during 2013 and supported the issue of bonds in primary markets as evidenced by the issue by AIB Mortgage Bank ('AIB MB') of bonds with a tenor of 3.5 and 5 years, and a nominal value of €0.5bn each. The improved position of the Irish sovereign and stabilisation of the fiscal position of the State and macro economy as a whole resulted in the stabilisation of Ireland's sovereign rating and indeed an upgrade to Baa3 by Moodys Investor Services ('Moodys') in January 2014. Institutional bank ratings were subject to negative rating action by Moodys in December 2013. AIB p.l.c (including EBS) deposit ratings were downgraded to Ba1. The Bank's covered bond programme is rated 'A' by Fitch Ratings, and Baa3 by Moodys.

The EBS wholesale funding strategy, prior to the merger of the Group and AIB p.l.c. in June 2011, would have envisaged the Bank to issue covered bonds in current markets. However, the position AIB Group finds itself in is one where it has two covered bond bank subsidiaries.

Having considered this situation, AIB Treasury has determined, for the time being, that future issuance in public covered bonds should be restricted to AIB Mortgage Bank. The role of the Bank being to continue to issue bonds on a retained basis in order that AIB Group maintain an adequate liquidity buffer.

As part of its mandate to support the Group's liquidity position the Bank issued covered bonds amounting to €225m during 2013. The bonds, which meet the European Central Bank ('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. The Bank did not issue any bonds to external investors during 2013.

While the operating environment improved over the course of 2013, conditions are expected to remain testing throughout 2014. Despite recent positive trends and exit from International Monetary Fund /

DIRECTORS' REPORT *(continued)*

ECB / European Union bailout, the Irish economy continues to face difficult challenges in light of fiscal consolidation. While critical elements of the economy such as the export sector performing well, property prices recovering in Dublin, Government finances improving, employment levels growing and the rate of unemployment falling, growth potential of the domestic economy remains constrained. It is anticipated that consumers will continue to predominantly focus on debt repayment, be it of mortgage or consumer debt, with subdued levels of demand for new mortgage credit. This will inhibit the ability of the Bank to source new mortgages from EBS in 2014.

The business strategy for 2014 is anticipated to continue to entail the provision of liquidity to AIB Group via the issue of suitably rated ECB repo eligible collateral, and maximise efficient use of mortgage collateral, subject to requirement of the Banks' cover pool management, ACS Act and rating agency requirements. The ongoing amortization of the cover pool, with all other things being equal, will result in declining nominal and regulatory OC levels, necessitating reduced levels of bonds in issue, and potentially including the re-purchase and cancellation of outstanding bonds.

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

Further information in relation to the Risk factors affecting the Bank are set out in the Risk Management Report.

GOING CONCERN

The financial statements for the year ended 31 December 2013 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment.

The Bank is dependent on its Ultimate Parent, AIB p.l.c. for continued funding and is therefore dependent on the going concern status of the Ultimate Parent.

The financial statements of AIB p.l.c. have been prepared on a going concern basis as the Directors of AIB Group are satisfied, having considered the risks and uncertainties impacting the AIB Group, that it has the ability to continue in business for the foreseeable future. In making its assessment, the Group 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. The AIB Group Directors have also considered the AIB Group's ability to access funding and liquidity. In addition, the AIB Group Directors have considered the commitment of support provided to AIB by the Irish Government through the programme for restructuring the Irish banking system with AIB designated as one of the two 'Pillar Banks'.

The Directors have also considered the Banks' financial plan approved by the Board in March 2014 which shows a return to profitability on 2014 together with the Bank's robust capital position.

On the basis of the continued availability of funding from AIB, the Banks' financial plan and robust capital position, the Directors of the Bank consider that it is appropriate to prepare the financial statements of the Bank on a going concern basis at this time .

DIRECTORS' REPORT *(continued)*

DIRECTORS' AND SECRETARY'S INTEREST IN SHARES
The beneficial interest of the Directors and the Secretary in office at 31 December 2013, 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 parent.

Ordinary Shares

	31 December 2013	1 January 2013*
Directors:		
Denis Holland	**Nil**	Nil
Fidelma Clarke	**Nil**	Nil
William Cunningham	**Nil**	Nil
Gerry Gaffney	**Nil**	Nil
Owen Purcell	**Nil**	Nil
Secretary:		
Sarah McLaughlin	**377**	377

** or date of appointment, if later.*

Share options
Details of the Directors' and the Secretary's options to subscribe for ordinary shares in AIB p.l.c. are given on the next page. The vesting of these options to the individuals concerned is dependent on Earnings Per Share ("EPS") targets being met by AIB p.l.c. Subject thereto, the options outstanding at 31 December 2013 are exercisable at various dates between 2013 and 2015. Details are shown in the Register of Directors' and Secretary's Interests, which may be inspected at the ultimate parent, Allied Irish Banks p.l.c, Bankcentre, Ballsbridge, Dublin 4, Ireland, registered office.

	31 December 2013	1 January 2013	Options lapsed during 2013	Weighted average subscription price of options outstanding 31 December 2013
Directors:				**€**
Fidelma Clarke	-	-	-	-
Gerry Gaffney	-	-	-	-
Owen Purcell	-	-	-	-
Secretary				
Sarah McLaughlin	-	-	-	-

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

DIRECTORS' REPORT *(continued)*

Long term incentive plans
There were no conditional grants of awards of ordinary shares outstanding to Group Non Executive Director, Executive Directors or the Secretary at 31 December 2013.

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

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

There were no changes in Directors' and Secretary's interests between 31 December 2013 and the reporting date.

Directors and Secretary
There were no changes to the Board during 2013.

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 Bank. To achieve this, the Directors have outsourced the maintenance of proper books and accounting records to EBS Limited finance function which employs 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 of the ultimate parent, Allied Irish Banks, p.l.c., Bankcentre, Ballsbridge, Dublin 4, Ireland.

INDEPENDENT AUDITOR
Deloitte & Touche, Chartered Accountants and Statutory Audit Firm, were appointed as auditors on the 30 July 2013. Deloitte & Touche have expressed their willingness to continue in office under Section 160(2) of the Companies Act, 1963.

On behalf of the Board

____________________, Chairman

____________________, Managing Director

Date: 12/3/ 2014

STATEMENT OF DIRECTORS' RESPONSIBILITIES

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

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law, the Directors are required to prepare the financial statements in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Acts, 1963 to 2013.

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

In preparing each of the financial statements, the Directors are required to:
• select suitable accounting policies and then apply them consistently;
• make judgements and estimates that are reasonable and prudent;
• state that the financial statements comply with IFRS as adopted by the EU; and
• prepare the financial statements on the going concern basis unless it is inappropriate to presume that the company will continue in business.

The Directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that its financial statements comply with the Companies Acts, 1963 to 2013. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the company and to prevent and detect fraud and other irregularities.

The Directors that are listed on page 2 confirm, to the best of their knowledge and belief, that the financial statements, prepared in accordance with IFRS as adopted by the EU, give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the company's affairs as at 31 December 2013 and of its results for the year then ended.

On behalf of the board

Director:	[signature]	Director:	[signature]
Date:	12/3/14	Date:	12 March 2014.

RISK MANAGEMENT REPORT

1. Introduction

The Group assumes a variety of risks in undertaking its business activities. Risk is defined as any event that could damage the core earnings capacity of the Bank, increase earnings or cash-flow volatility, reduce capital, threaten business reputation or viability, and/or breach regulatory or legal obligations.

The Group has a clearly defined Risk Governance structure and framework that is commensurate with the size, scale and complexity of the organisation. Over the course of 2013, the Group aligned and integrated its risk management structures and frameworks with the AIB Group.

The Bank, as an integrated member of EBS has adopted a risk management structure and controls framework consistent with that of the Group. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of the Group's risk management framework. In addition, the key risk factors to which the Bank is exposed are set out in the section below. The governance and organisation framework through which the Group manages and seeks where possible to mitigate its risks is described below.

2. Risk Management Framework

The Group has adopted an Enterprise Risk Management approach to identifying, assessing and managing risks, the core elements of which are set out in a revised Enterprise Risk Management Framework ('ERM'), which was approved by the AIB Group Board during 2012.

This framework is in turn supported by a number of frameworks covering the management of specific risk categories in which AIB Group has its most significant actual or potential risk exposures (credit risk, operational risk, etc) which were reviewed and approved by the AIB Group Board and adopted by the Group during 2013.

The Board approved frameworks create clear ownership and accountability; ensure the Bank's most significant risk exposures are understood and managed in accordance with agreed risk appetite (for financial risks) and risk tolerances (for non-financial risks); and ensures regular reporting of both risk exposures and the operating effectiveness of controls.

The Bank 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 the Bank's strategic objectives. The primary focus of the risk management framework is to:

- Identify the Bank's significant risks and improving the control and co-ordination of risk taking across the business; and
- Ensure that business plans are properly supported by effective risk infrastructure and subject to strong and independent review and challenge structures.

The Bank is also subject to the monitoring of specific risks by the Cover-Asset Monitor as set out in the Asset Covered Securities Act.

The core aspects of the Bank's risk management approach are described below.

3. Risk governance and risk management organisation

The Banks' Risk management is aligned with a clear risk management governance structure supported by the the Group. Risk management in the Group was aligned with a clearly defined risk governance structure at AIB Group level during 2013.

RISK MANAGEMENT REPORT *(continued)*

The AIB Group ERM framework provides a robust and consistent approach to risk management across the Group and is a core component of the Group's Internal Governance framework.

Throughout 2013 the integrated governance, risk and control frameworks were further embedded continuing the use of a consistent approach to risk appetite, delegated authorities and governance committee structures.

The Group has adopted a 'three lines of defence' framework in the delineation of accountabilities for risk governance. Under the three lines of defence model, primary responsibility for risk management lies with the business line management. The Risk Management Functions provide second line of defence, providing independent oversight and challenge to business line managers. The third line of defence is the AIB Group Internal Audit function which provides independent assurance to the Group on the effectiveness of the system of internal controls.

Whilst the Board has ultimate responsibility for all risk taking activity within the Bank; it has delegated a number of risk governance responsibilities to various committees (both EBS Group and AIB Group) or key officers (both EBS Group and AIB Group) which are outlined below. Governance is maintained through delegation of authority from the Board, down through the management hierarchy supported by the committee based structure designed to ensure that the Group's risk appetite, policies, procedures, controls and reporting are fully in line with regulations, law, corporate governance and industry good-practice.

The Board was supported in 2013 by the work of the EBS Board Audit Committee ("BAC"). The BAC supported the Board in reviewing existing internal control mechanisms to assess whether they are adequate and whether they are performing effectively, and in assessing adherence with laws and regulations in 2013.

A Board Audit, Risk and Compliance Committee was in place until 14 May 2012. Consideration of risk matters reverted to the Board at that time and an Audit and Compliance Committee was retained. In January 2013 the Board resolved that consideration of all audit and compliance matters should also revert to the Board, having regard for the circumstances of the Bank and the wider AIB Risk Framework and Governance structures within which it operates.

The Banks' Executive Management Team has responsibility for the management of the business as a whole including the origination of mortgages from the Group 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.

3.1 Risk Committees and Functions

The Bank is supported in its risk activities by a number of Group risk committees and by the AIB Group Risk functions which support the Bank and the Group in developing and maintaining a robust risk management framework, and by providing independence in terms of risk identification, measurement, monitoring and reporting.

During 2013 the supporting risk committees comprised of the Group Asset & Liability Committee, the Group Risk Rating Approval Committee and the Group Executive Risk Committee (ERC). Each of these committees, whose membership is approved by the EBS Managing Director, were responsible for identifying actions to support robust risk management in line with the Group risk appetite. Progress was monitored and reported regularly to the EBS Board through the report of the EBS Chief Risk Officer. Representatives from AIB Group Risk participated and attended each of the EBS Risk Committees as part of the alignment and oversight by AIB Group.

RISK MANAGEMENT REPORT *(continued)*

Following a further review of risk governance in late 2012, the roles and responsibilities of a number of Group Risk Committees, namely the Credit Risk Committee and the Operational Risk and Compliance Committee, which were in place during 2012, were amalgamated to form one Executive Risk Committee (‘ERC’). The main purpose of the ERC which was established in January 2013 which meets monthly, is to monitor, review and recommend an appropriate risk governance structure and risk appetite for the Group. In addition, the ERC is responsible for evaluating the adoption of AIB Group policies or alignment of EBS policies and providing recommendations to the Board in line with the overall risk appetite of the Group and AIB Group.

The ERC is also responsible for monitoring the make up and performance of the loan books and the adequacy of provisions for impaired loans. The evaluation of Counterparty Credit Risk and Limit setting is performed at AIB Group level.

The Committee monitors the external macro-economic and other factors and new business credit risk trends and projections which serve as a benchmark against which the credit risk appetite of the organisation is evaluated.

The Asset & Liability Committee (‘ALCO’), which met monthly in 2013, was established to monitor Group’s exposure to key market risks, i.e., liquidity risk, funding risk, interest rate risk in the banking book and foreign exchange risk and its capital rates. The Committee was responsible, in conjunction with AIB Group ALCO, for monitoring the adequacy of the liquidity framework and buffers, and for recommending the appropriate Group funding and capital policies and plans to the Board for approval in line with AIB Group policies and planning. Responsibility for asset liability management has been outsourced to AIB Group ALCO.

The EBS Risk Rating Approval Committee (‘RRAC’), which met semi-annually in 2013, was responsible for the ongoing validation and monitoring of risk rating systems, model performance and model output in terms of forecasting.

In line with the AIB Group stress testing framework, the Group measures it’s vulnerabilities to loss under stressed market conditions and considers those results when agreeing financial budgets and on an ongoing basis for monitoring and reviewing risk appetite and risk contingency plans. The stress testing framework, which forms an integral part of the overall governance and risk management culture of the Group, has been developed in line with the European Banking Authority revised guidelines on stress testing which became effective on 1st January 2011. The stress testing program incorporates stress tests at both an individual risk level (bottom up approach) and at a holistic organisation wide level (integrated top down approach) that cover a range of risks and business areas. The stress testing program facilitates the development of risk mitigation or contingency plans across a range of stressed conditions that are used to support the organisation from a risk appetite, capital and liquidity management perspective. Contingency plans also reflect operational response considerations where appropriate.

4. Risk Appetite Statement and Risk Polices

The Bank’s risk appetite is defined as the maximum amount of risk that the Bank is prepared to accept in order to deliver on its strategic and business objectives. The Bank maintains its own risk appetite statement (‘RAS’) which was updated in 2013 to align with both the EBS Group and AIB Group RAS.

The RAS is a blend of qualitative and quantitative limits and triggers linked to the Bank’s objectives. Risk appetite limits and targets are cascaded where appropriate into more granular limits and targets.

In turn, risk policies and procedures are updated, where appropriate, to reflect the limits of risk appetite across the Group.

RISK MANAGEMENT REPORT *(continued)*

These policies are closely managed on a day to day basis throughout the Group, and are monitored by specific business units with oversight by the relevant Group risk committees. Material changes to these policies are assessed by the Bank's Executive Management team on an annual basis and subsequently recommended to the Board for approval.

The Bank's risk profile is measured against its risk appetite regularly and reported to the Executive Management Team and Board.

Material breaches of AIB Group risk appetite, if they occur, are escalated by the AIB Board to the Central Bank. The RAS will be reviewed during Quarter 2 2014, following completion of a review of AIB Groups' RAS which is currently underway.

5. Risk Factors

EBS's approach to identifying and monitoring the principal risks and uncertainties facing the Group is informed by risk factors. All of the Group's 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 the Group's and the Bank's risk management framework, as described below. The principal risks and uncertainties facing the Bank are as follows:

5.1 The Bank's dependence on the EBS and AIB Group for Liquidity and Capital Management

The Bank is dependent on the Group in relation to the origination, and to AIB Group in relation to the 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 a dependency on EBS and AIB Group. Until recently, the AIB Group and EBS has been operating in an exceptionally challenging environment where wholesale market conditions restricted the AIB Groups' access to wholesale funding other than short duration and mainly secured funding. However, there has been recent improvement in market sentiment towards Irish issuers and the AIB Group has re-engaged in the wholesale funding market through the issuance of long dated secured and unsecured debt. However, any renewed stress or deterioration in credit market conditions could further restrict the AIB Groups' access to wholesale funding with consequent access on the Group and the Bank.

To meet its funding requirements, AIB Group has accessed a range of Central Bank liquidity facilities, including certain additional liquidity schemes introduced by central banks for market participants during periods of dislocation in the funding markets. This included a switch from short term ECB drawings into two 3-year longer-term refinancing operations in December 2011 and March 2012. In accessing Central Bank and other secured lending facilities, AIB Group has relied significantly on its qualifying liquid assets. The completion of the deleveraging programme combined with a stable customer deposits base has reduced the AIB Groups' reliance on ECB funding and central bank liquidity facilities. The Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 (Statutory Instrument No. 490 of 2009), as amended (the "ELG Scheme") was closed to covering further liabilities on 28 March 2013 (the Group (UK) p.l.c. announced its withdrawal from the ELG scheme in August 2012) and to date this event has had a negligible impact on deposit balances. However, in the unlikely event that the AIB Group exhausts its stock of available collateral for funding and unsecured funding is unavailable, it would be necessary to seek alternative sources of funding, including continued support by the Irish Government.

RISK MANAGEMENT REPORT *(continued)*

The Bank is largely dependent on the Group who in turn is dependent on AIB Group to provide the necessary capital resources to meet minimum regulatory requirements. AIB Group carries out extensive forward-looking stress tests on its capital position on a quarterly basis and, over the course of 2013, these have confirmed that the bank does not require additional capital within the defined stress level.

However, given the levels of uncertainty in the current economic environment, there is a possibility that the economic outturn over the capital planning period may be materially worse than the stress scenario envisaged and/or that losses on AIB Groups' (including EBSs') credit portfolio may be above forecast levels. Were such losses to be significantly greater than currently forecast, there is a risk that the AIB Groups' capital position could be eroded to the extent that it would have insufficient capital to meet its regulatory requirements with consequent impact to the Group and in turn to the Bank in meeting the required regulatory ratios.

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

The Capital Requirements Regulation (CRR) and the Capital Requirements Directive (CRD), the EU's implementation of the Basel III reforms, were published in the EU Official Journal on 27 June 2013. As a result of these regulations, credit institutions may be required to increase the quantity and quality of their regulatory capital. Full details of requirements in this regard have yet to be confirmed by the competent authorities, and it is possible that the AIB Group and EBS's target regulatory capital requirements may ultimately increase as a result.

The Central Bank of Ireland conducted a Balance Sheet Assessment of the three credit institutions covered under the Eligible Liabilities Guarantee during Q4 2013. This review included an assessment of asset quality, risk weighted assets and point in time capital as of 30 June 2013. The AIB Group has been advised of the findings of this review and has considered them in the preparation of the Group's year end December 2013 provisions and financial statements.

In addition, the ECB announced during October 2013 that it will undertake a comprehensive assessment of the banking system, to be concluded in October 2014. This ECB exercise will entail a Supervisory Risk Assessment, an Asset Quality Review and a Stress Test to provide a forward-looking view of banks' shock absorption capacity under stress. The outcome of these assessments may lead to a range of follow-up actions for banks, possibly including requirements for changes in the AIB Group and EBS's provisions or capital.

5.3 The Group's business may be adversely affected by a further deterioration in economic and market conditions

Deterioration in the performance of the Irish economy or other relevant economies has the potential to adversely affect the Group's overall financial condition and performance. Such deterioration could result in reductions in business activity, lower demand for the Group's products and services, reduced availability of credit, increased funding costs, decreased asset values and additional write downs and impairment charges.

While there are some signs of improvement and stabilisation in the Irish economy, any renewed stress or deterioration could impact the return of normalised markets for commercial and residential property. As the Group remains heavily exposed to the Irish property market a prolonged delay in the recovery of the Irish market could have a negative impact on levels of arrears, the Group's collateral values and consequently have a material impact on the Group's future performance and results with consequent impacts on the Bank.

5.4 General economic conditions continue to be challenging for mortgage and other lending to customers and increase the risk of payment default

The Group remains heavily exposed to the Irish residential property market. General economic conditions continue to be very challenging for customers. A continued high level of unemployment together with any further reduction in borrowers' disposable income (due to for example current and future budgetary measures and reduction in salaries) has the potential to negatively impact customers' ability to repay existing loans. This could result in additional write downs and impairment charges for the Group and negatively impact the capital and earnings position of the Bank. Challenging economic conditions will also influence the demand for credit in the economy. A declining or continuing muted demand for credit has the potential to impact the Group's financial position.

Furthermore, since 2011 a number of initiatives and regulations were introduced following the Inter-Departmental Working Group on Mortgage Arrears, including the publication of the 'Keane Report', the revised Code of Conduct on Mortgage Arrears 2011 , the Consumer Protection Code 2012, the 2012 Code of Conduct for Business Lending to Small and Medium Enterprises, the requirement for Mortgage Arrears Resolution Strategies as outlined in the Code of Conduct on Mortgage Arrears 2013 which replaced the 2011 Code.

Overall, there is an increased risk of further impairment to the Group's residential mortgage and commercial property loan portfolios, leading to higher costs, additional write-downs and lower profitability for the Group.

5.5 The depressed Irish property prices may give rise to increased losses by the Bank

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

Following significant increases between 1995 and 2006, residential property prices peaked in 2007 and showed consistent month on month declines from late 2007 to early 2012. The trend over 2012 was more stable. 2013 has shown marginal improvement with prices up 6.4% nationally from January to December 2013. Overall, the national index is 46% lower than its highest level in 2007.

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 due to the Bank. This 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. 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.

5.6 Extensive powers continue to be conferred on the Irish Minister of Finance

The Credit Institutions (Stabilisation) Act 2010 (the "Stabilisation Act") conferred extensive powers on the Irish Minister for Finance to direct the affairs of and restructure credit institutions and reorganise their assets and liabilities. Pursuant to the Act, directors are required to act in a manner that is aligned to the interests of the State in the performance of their duties, having regard to public interest considerations specified in the Act. The Stabilisation Act will cease to have effect on 31 December 2014, the operation of the Stabilisation Act having been extended by resolution of both Houses of the Oireachtas (ie. the Irish parliament) at the end of 2012.

RISK MANAGEMENT REPORT *(continued)*

5.7 The Bank's business activities must comply with increasing levels of regulation

In 2013 significant volumes of new regulations were issued by both by the Central Bank of Ireland and the European Union. A particular focus in light of the mortgage forbearance issue has been the introduction of a revised Code of Conduct on Mortgage Arrears and the new Personal Insolvency legislation which had taken full effect by December 2013. A risk arises from potential changes in customer attitude to debt obligations given that the new legislation allows for the agreed settlement of unsecured debt, and the settlement and/or restructuring of secured debts up to a maximum of €3 million. The inclusion of secured debt in the non-judicial process is unprecedented, and therefore, it is difficult to gauge its impact. The legal uncertainty with regard to the availability of certain remedies for the enforcement of mortgages over Irish land entered into prior to 1 December 2009 has been removed by the Land and Conveyancing Law Reform Act 2013 which was enacted on 24 July 2013.

The long anticipated revision to the EU Capital Requirements Directive and Regulation (CRD IV) comes into force on 1st January 2014 and will be gradually implemented over 5 years. This omnibus legislation will, among other measures, increase capital buffers and introduce new liquidity and leverage ratios for greater transparency. It also provides for the introduction in November 2014 of a new banking supervisory system (a Single Supervisory Mechanism) which will see the Eurozone's largest banks, including AIB Group and its subsidiaries, coming under the direct supervision of the European Central Bank. Other measures likely to impact on the business in 2014 include the Credit Reporting Bill creating a new centralised credit bureau and the revised Corporate Governance Code.

The delivery of this level of regulatory change will place strain on the organisation's resources, particularly during a period of significant restructuring and consolidation.The challenge of meeting tight implementation deadlines while balancing competing resource priorities and demands adds to the regulatory risk to the Group and the Bank. They may also impact significantly on the Group's and the Bank's future product range, distribution channels, funding sources, capital requirements and consequently, reported results and financing requirements.

6. Risk Disclosures

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, business, operational, compliance and financial (including credit, liquidity, market and over collateralisation) 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.

Business Risk

Business risk encompasses the internal and external factors that can impact on the Bank's performance and comprises the Bank's values and beliefs, strategy and business planning risk, income and cost management risk, customer management framework risk, change management risk and modelling and scenario analysis risk change readiness, strategic plan management, remuneration, third party relationship management, brand management, distribution strategy, leadership and communication. Business risk also encompasses external trends which cannot be controlled but which could have a significant impact on the Bank's business such as the economic environment, market developments and technological innovation. Business risks are managed and monitored in the main by the senior management team and the Board. Significant developments are reported to the Board directly on a regular basis.

RISK MANAGEMENT REPORT *(continued)*

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. As such, operational risk encompasses a very broad range of sources of potential financial loss which the Bank actively seeks to mitigate, transfer and control including for instance, business continuity, fraud, outsourcing and technology risks.

AIB Group Operational Risk is responsible for supporting the Bank in the management of Operational Risk. The Bank has adopted relevant AIB Group Operational risk policies which defines the Group's approach to identifying, assessing, managing, monitoring and reporting the operational risks which may impact the achievement of the Bank's business objectives. The core focus of Operational risk management in the Bank 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 Asset Covered Securities 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 the Bank fails to meet its legislative or regulatory requirements as set out by the Central Bank and where applicable, by the European Banking Authority. Compliance independently evaluates adherence to key regulations and updates management via the Group ERC. An overall annual plan is developed for the AIB Group which includes EBS Group.

AIB Group Regulatory Compliance is responsible for supporting the Bank in monitoring adherence to its regulatory compliance obligations. EBS adopted the AIB Group regulatory compliance policies in 2012. The core focus of regulatory compliance risk management is on supporting the Banks' adherence with the requirements of the Asset Covered Securities Act, terms and conditions of its banking license, the Capital Requirements Directive and conditions of the government guarantee scheme.

Financial Risk

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

AIB Group 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 interest rate risk, foreign exchange risk, duration mismatch and interest coverage.

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 Group. The Directors are also satisfied that the Bank is protected under the legislation such that in the event of any parental insolvency that the liabilities due to the Bondholders as secured creditors can be met in priority to unsecured creditors.

RISK MANAGEMENT REPORT *(continued)*

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

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

Liquidity risk*

Liquidity risk relates to the ability of the Bank 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 the Bank elected to meet its solo prudential liquidity requirements at a Group level which during 2013 was amended to be at an AIB Group Level.

EBS was acquired by the AIB Group on 1st July 2011 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.

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

The Group conducts both regular and ad-hoc funding and liquidity risk stress testing to assess, on an ongoing basis the ability of the Group 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.

The Group 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 Group 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. The Group has conducted stress tests in advance of these expected changes. Funding contingency plans are continually under review in light of unprecedented market events.

Key measures used by the Group 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 the EBS Management team and onwards to the Board.

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

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

RISK MANAGEMENT REPORT *(continued)*

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' s income. The objective of market risk management is to manage and control market risk exposures within acceptable parameters, while optimising the return on risk. EBS is in the process of aligning the measurement methods and reporting of its market risk exposures to the AIB Group.

The Bank is not allowed to engage in proprietary trading under the conditions of the Asset Covered Securities Act (Asset Covered Securities Act) and its' license. AIB Group Treasury manages non trading Interest Rate Risk using gap and sensitivity analysis. Derivatives such as interest rate swaps are used to hedge these market risks. The EBS Management team monitors these risks monthly and reports on key developments to the Board on a regular basis.

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 Asset Covered Securities Act and internal parameters.

The Bank has outsourced the measurement and reporting management of its interest rate risk to the Group. EBS Treasury Risk in conjunction with AIB Group 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 EBS Mortgage Finance Management team is responsible for monitoring how interest rate risk is managed and ensuring that the Bank's policy is adhered to.

Credit Risk*

Credit risk is the risk of financial loss to the Bank 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 must be originated by the Group in accordance with lending policies approved by the Board of directors of the Group as applicable at the time of origination of the loan as reflected in the Wholesale Mortgage Origination Agreement between the Group and the Bank.

Credit risk management at the 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 continued deterioration in credit quality throughout 2013 in the retail market, both credit management and credit risk management have continued to be a key area of focus during 2013. Resourcing, structures, policy 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 ERC is responsible for reviewing appropriate credit risk management structures, forbearance strategies and policies in line with the credit risk appetite of the Group and AIB Group and for monitoring the performance of the book.

The AIB Risk Analytics team 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 the Bank's loan assets. Credit impairment provisions are in line with International Financial Reporting Standards, the calculation and management of which are outsourced to the Group.

**Forms an integral part of the audited financial statements*
RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

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. Given the economic environment, the Group conducts a quarterly assessment of impairment provisions, assisted by the Risk Analytics and Credit teams and evaluated by the Executive Risk Committee.

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 including committed facilities:

	2013	2012
	€m	€m
Non-derivative financial assets		
Loans and advances to customers	**5,983**	6,427
Loans and advances to credit institutions	**89**	128
Derivative financial instruments	**33**	35

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 of the collateral 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 2013 and 2012.

Collateral Held: Loans and advances to customers

	2013	2012
	€m	€m
Impaired loans	**974**	802
Past due but not impaired	**417**	430
Not impaired/ Not past due	**4,171**	4,455
Total loans	**5,562**	5,687

Residential mortgages*
The Bank does not originate lending in its own right, but originates loans on a wholesale basis periodically from the Group. While the Group considers a borrower's repayment capacity to be paramount in granting any loan, the Group 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 2013 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.

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Measurement of credit risk
One of the objectives of credit risk management is to accurately quantify the level of credit risk to which the Group is exposed. The use of internal credit rating models is fundamental in assessing the credit quality of loan exposures.

The primary model measures used are:
– Probability of default (“PD”) – the likelihood that a borrower is unable to repay his obligations;
– Exposure at default (“EAD”) – the exposure to a borrower who is unable to repay his obligations at the point of default; and
- Loss given default (“LGD”) – the loss associated with a defaulted loan or borrower.

To calculate PD, the Group assesses the credit quality of borrowers and other counterparties and assigns a credit grade or score to these. This grading is fundamental to the on-going credit risk management of loan portfolios.

Models generally use a combination of statistical analysis (using both financial and non-financial inputs) and expert judgement. For the purposes of calculating credit risk, each probability of default model segments counterparties into a number of rating grades, each representing a defined range of default probabilities (details of these rating scales are published in the Group’s Pillar 3 disclosures).

Exposures migrate between rating grades if the assessment of the counterparty probability of default changes. These individual rating models continue to be refined and recalibrated based on experience. In the retail portfolio, which is characterised by a large number of customers with small individual exposures, risk assessment is largely automated through the use of statistically-based scoring models.

Mortgage applications are generally assessed centrally with particular reference to affordability, assisted by scoring models. Both application scoring for new customers and behavioural scoring for existing customers are used to assess and measure risk as well as to facilitate the management of these portfolios.

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

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

Non-Performing
The Group’s criticised loans are subject to more intense assessment and review because of the increased risk associated with them.

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Given the on-going deterioration in credit quality throughout 2012 and 2013 in the residential, retail and commercial markets, credit management and credit risk management continued to be the key area of focus. Resourcing, structures, policy and processes are subjected to on-going review in order to ensure that the Group is best placed to manage asset quality and assist borrowers in line with agreed treatment strategies.

Provisioning for impairment*
The accounting policies of loans and advances to customers are outlined in accounting policies. 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.

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 insignificant, it is reviewed on a pooled or collective basis. Provisions are also calculated on a pool basis for individual assets where there is no objective evidence of individual impairment yet, under the incurred but not reported ("IBNR") assessment. 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 a customer makes a request for advanced forbearance. Categories of loans that will be classed as impaired regardless of arrears include loans where the property is in possession of the Group 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 loans and treasury assets. The threshold for retail assets is set at €0.75m. Assets which are impaired and which are significant are automatically assessed 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.

Collectively Assessed Provisions*
Individually insignificant mortgage specific provisions are calculated using a collective mortgage provisioning model.

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

This methodology is based on the calculation of three possible resolution outcomes: cure; advanced forbearance with loss; and repossession (forced and voluntary), with different loss rates associated with each. This replaces the existing two outcomes, repossession and This replaces the existing two outcomes, repossession and cure.

The methodology has been updated to reflect current data on loss history and portfolio development as well as incorporating additional loss parameters assessed on restructuring outcomes.

The model parameters at 31 December 2013 for owner occupier mortgages are as follows: cure (4%); and repossession/advanced forbearance (96%).

The corresponding buy-to-let model parameters are as follows: cure (1%) and repossession/advanced forbearance (99%).

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

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

The model parameters are reviewed at a Group Credit Committee on a quarterly basis.

All loans where the specific provision is zero, whether or not an individual assessment is completed, are part of the collective provision calculation. These are termed the incurred but not reported (IBNR) provisions.

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

IBNR provisions can only be recognised for incurred losses i.e. losses that are present in the portfolio at the reporting date and are not permitted for losses that are expected to happen as a result of likely future events. IBNR provisions are determined by reference to loss experience in the portfolio and to the credit environment at the reporting date. IBNR provisions are maintained at levels that are deemed appropriate by management having considered and having taken into account:

– historical loss experience in portfolios of similar credit risk characteristics (for example, by sector, loan grade or product);

– the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate provision against the individual loan (emergence period);

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

– management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience; and
– an assessment of higher risk portfolios, which include but are not limited to: non-impaired forborne mortgages; loans graded with a vulnerable credit rating; and loans > 90 days past due but not impaired.

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

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 employment and GDP).The rate movement from default to repossession is assessed according to the number of payments missed – the deeper in default a loan is, the more likely it is that loss will result.

The calculation of incurred loss is driven largely by expectation of property values at disposal.
In this note, impaired assets are those for which a specific provision has been made.

The portfolio IBNR is calculated using the collective mortgage model as described above. The table below sets out the parameters used in the calculation of IBNR for the mortgage portfolio:

Mortgage Portfolio/IBNR (Unaudited)

Grade	**Average PD (%)**	**Average LGD (%)**
Good Upper	1.1	18.7
Good Lower	4.0	24.7
Watch	16.9	21.4
Vulnerable	52.8	22.0

	Average PD (%)	Average LGD (%)
Performing	6.0	20.3
Non-performing non-impaired	95.4	23.7

The parameters for Cured and Forborne – non-impaired, are set out below. As a result, these sub portfolios carry a higher level of IBNR:

Cured	20.5	20.4
Forborne Not Impaired	19.4	21.7

Average PD and LGD are based on the PDs and LGDs, weighted by the EAD for all owner-occupier and buy-to-let loans included in the collective mortgage model. The mortgage provision model calculates individually insignificant specific provisions and IBNR run rate provisions.

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Any additional IBNR as determined by management judgement is applied at a portfolio level and is not included in the analysis above.

Non-performing, non-impaired loans in the table above are defined as loans that are more than 90 days past due but not impaired.

Emergence period

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

Performing provisions assets are split into homogenous pools on the basis of similar risk characteristics. The asset pools are multiplied by the “average annual loss rate” for that pool, suitably adjusted where appropriate for any factors currently affecting the portfolio, which may not have been a feature in the past or vice versa. The resultant amount is then multiplied by the ‘emergence period’ for that pool to arrive at the IBNR Collective Impairment Provision. Loss rates are updated half yearly and emergence periods for each pool of loans are reviewed annually.

For the year ended 31 December 2013, the emergence period for the Republic of Ireland mortgage portfolio has moved from 6 months to 9 months resulting in an additional provision of € 168 million. The increase has been observed as more historical data has become available, particularly for the forbearance portfolio and customer behaviour has been observed over a longer period of time.

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment provisions on both individually and collectively assessed loans and receivables. The most significant judgemental area is the calculation of collective impairment provisions. They are subject to estimation uncertainty, in part because of the large number of individually insignificant loans in the portfolio.

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

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience.

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

For example, loss rates and the expected timing of future recoveries are benchmarked against actual outcomes where available to ensure they remain appropriate.
However, the exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas.

The key variables include peak-to-trough house price (which determines the collateral value supporting loans in the mortgage portfolio) and cure rates (rates by which defaulted or delinquent accounts are assumed to return to performing status).

Altering the key assumptions for provisions has varying impacts on the overall provision numbers.

The following table shows the relative impacts of standardised changes:

Impairment Sensitivities 2013

Factor	
1. Probability of Default: Emergence Period	- Increasing the emergence period from 9 to 12 months would increase the IBNR (collective provision) by 37.0% for home loans.
2. Probability of Default: Cure Rate	- A 1% increase in cure rate would decrease the collective provision by 1.2% for home loans.
3. Roll rate from repossession to loss: Higher roll rates assumed	- A 1% increase in repossession rate would increase the collective provision by 0.4% for home loans.
4. Loss Given repossession: Higher reductions in house prices from peak	- A increased Peak-to-Trough assumption (from 55% to 57%) would increase the collective provision by 3.9% for home loans.

Impairment Sensitivities 2012

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 home loans.
2. Probability of Default: Macroeconomic factors	- A 2% fall in employment leads to a 4.3% increase in collective provisions for Retail assets (home loans and Buy-to-Lets) - The GDP and GNP numbers alone have little influence.
3. Roll rate from repossession to loss: Higher roll rates assumed	- An increase in 5% of the repossession rate will result in a 10.6% movement in stock of provisions.
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%.

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RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

The impairment sensitivities for 2012 are based on the 2012 Retail II mortgage model. This model was updated in 2013. These figures are unaudited.Credit risk can also be affected by macro-economic factors such as increased interest rates, increased unemployment, lower consumer spending, personal and corporate defaults/insolvency levels. The credit portfolio is also subjected to on-going stress testing and scenario analysis. Events are modelled at a Group wide level, at a segment and business unit level and by rating model and portfolio.

Sensitivity analysis is the simple stressing of one risk driver to assess the Group's sensitivity to that risk driver. A risk driver is defined as an internal or external factor which has the potential to cause loss or damage to the Group e.g. macroeconomic risk drivers (GDP, unemployment rate etc.) and specific credit risk drivers (shift in PDs).

4. Credit Profile*

The analysis below in relation to residential loans for the Bank is based on gross lending before unearned income and impairment provisions of €381m (2012: €244m).

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. The numbers presented are inclusive of unearned income and other related income. The 2012 comparatives have been represented throughout this section and throughout the risk disclosures.

Loans and advances to customers		**2013**			2012	
	Core €m	**Non-core €m**	**Total €m**	Core €m	Non-core €m	Total €m
Residential mortgages	**6,345**	**19**	**6,364**	6,655	16	6,671

Asset quality has been affected by an increase in the level of arrears, with 68.8% of the combined loan book maintaining a satisfactory payment profile in 2013 compared with 72.7% for 2012. The change in loan quality is reflected in a higher level of provisions, detailed below.

Impairment provisions		**2013**			2012	
	Core €m	**Non-core €m**	**Total €m**	Core €m	Non-core €m	Total €m
Statement of financial position provisions	**376**	**5**	**381**	241	3	244
Statement of financial position provisions as a % of loans and advances	**5.9%**	**26.3%**	**6.0%**	3.6%	18.8%	3.7%
Specific provision as a % of impaired loans	**27.0%**	**40.0%**	**27.1%**	18.9%	37.5%	19.0%
Impairment charge as a % of total loans	**2.1%**	**26.3%**	**2.2%**	1.4%	37.5%	1.5%

The Bank's loans and advances to customers amounted to €6,364m at 31 December 2013 and have decreased by €307m since December 2012. 31.2% or €1,987m (2012: 27.3% or €1,818m) of total Bank loans and advances to customers are criticised of which €1,238m or 19.5% (2012: €1,052m or 15.8%) is impaired.

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RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Statement of financial position impairment provisions of €381m (2012: €244m) provide cover on impaired loans of 30.8% (2012: 23.2%) and on total loans of 6.0% (2012: 3.7%).

Coverage rates on impaired loans have increased as a result of changes to the assumptions underpinning the provision calculation process in line with the CBI guidelines issued during 2013 on the estimation of impairments and losses. As an example losses are now assumed to occur for loans not likely to go to possession.

The income statement provision charge in 2013 was €129m or 2.0 % of total loans. The charge is up from €94m or 1.4% of total loans in 2012.

Residential mortgages*

Residential mortgages amounted to €6,364m at 31 December 2013. This compares to €6,671m at 31 December 2012, the decrease driven primarily by repayments and redemptions during 2013. The split of the residential mortgage book is owner-occupier, €6,345m and buy-to-let, €19m. The income statement impairment provision charge for 2013 was €129m or 2.0% for Residential mortgages. The statement of financial position impairment provisions of €381m is held at 31 December 2013, split €335m specific and €46m collective.

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RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Residential Mortgages - Total

	2013			2012		
	Core €m	**Non-Core €m**	**Total €m**	Core €m	Non-Core €m	Total €m
Total residential mortgages	**6,345**	**19**	**6,364**	6,655	16	6,671
Not past due and not impaired	**4,630**	**9**	**4,639**	5,093	7	5,100
Arrears						
1 - 30 DPD^ but not impaired	**274**	**-**	**274**	312	-	312
31 - 60 DPD but not impaired	**108**	**-**	**108**	118	1	119
61 - 90 DPD but not impaired	**78**	**-**	**78**	65	-	65
91 - 180 DPD but not impaired	**27**	**-**	**27**	23	-	23
181 - 365 DPD but not impaired	**-**	**-**	**-**	-	-	-
Impaired Loans	**1,228**	**10**	**1,238**	1,044	8	1,052
Loans impaired and not in arrears	**102**	**-**	**102**	108	-	108
Loans impaired and in arrears	**1,126**	**10**	**1,136**	936	8	944
- of which 1 - 30 DPD	**34**	**-**	**34**	33	-	33
- of which 31 - 60 DPD	**26**	**-**	**26**	29	-	29
- of which 61 - 90 DPD	**41**	**-**	**41**	33	-	33
- of which 91 - 180 DPD	**189**	**1**	**190**	177	1	178
- of which 181 - 365 DPD	**259**	**2**	**261**	252	3	255
- of which over 365 DPD	**577**	**7**	**584**	412	4	416
Total Arrears (30+ DPD and/or impaired)	**1,441**	**10**	**1,451**	1,250	9	1,259
90+ DPD Arrears (90+ DPD and/or impaired)	**1,255**	**10**	**1,265**	1,067	8	1,075
Provisioning						
Statement of financial position specific provisions	**331**	**4**	**335**	197	3	200
Statement of financial position IBNR provisions	**45**	**1**	**46**	44	-	44
Income statement specific provisions YTD	**129**	**6**	**135**	56	1	57
Income statement specific IBNR provisions YTD	**3**	**(1)**	**2**	38	5	43
Specific provisions / impaired loans cover			**27.1%**			19.0%

^ = DPD is Days past due

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

The portfolio has experienced an increase in arrears. This is due to the harsh economic climate of the last few years. Even though 2013 has seen an improvement in the overall economy, it is likely that this will be not impact on borrowers' repayment affordability until 2014 and later. The level of loans >90 days in arrears or impaired was 19.9% at 31 December 2013 compared with 16.1% at 31 December 2012.

The level of loans >90 days in arrears or impaired in the owner occupier book has increased significantly since 31 December 2012 from €1,067m (16.0% of mortgages) to €1,255m or 19.8% at 31 December 2013. 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 moved from €8m (50.0% at 31 December 2012) to €10m (52.6% at 31 December 2013).

Total owner occupier and BTL loans >90 days past due or impaired amounted to €1,265m at 31 December 2013. Total specific provisions of €335m provided cover of 26.5% of impaired loans and have been raised due to the continued increase in >90 days past due or impaired loan balance.

Moreover, the coverage has increased due to the new methodology of assigning losses to loans not likely to be repossessed. Statement of financial position collective provisions of €46m are held for the performing book (0.9%) of the performing residential mortgage book) based on management's view of incurred loss in this book. The total income statement charge for 2013 was €137m (specific €135m and collective €2m).

The Bank has received a number of requests for forbearance from customers who are experiencing cash flow difficulties. The Bank considers these requests 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.

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	**2013**				2012			
	Core	**Non-core**	**Total**		Core	Non-core	Total	
	€m	**€m**	**€m**	**%**	€m	€m	€m	%
Satisfactory	**4,369**	**8**	**4,377**	**68.8**	4,848	5	4,853	72.7
Watch	**510**	**1**	**511**	**8.0**	542	2	544	8.2
Vulnerable	**238**	**-**	**238**	**3.7**	221	1	222	3.3
Impaired	**1,228**	**10**	**1,238**	**19.5**	1,044	8	1,052	15.8
Criticised	**1,976**	**11**	**1,987**	**31.2**	1,807	11	1,818	27.3
Gross loans	**6,345**	**19**	**6,364**	**100.0**	6,655	16	6,671	100.0
Criticised as a % of total gross loans	**31.1%**	**57.9%**	**31.2%**		27.2%	68.8%	27.3%	
Impaired as % of total gross loans	**19.4%**	**52.6%**	**19.5%**		15.7%	50.0%	15.8%	

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RISK MANAGEMENT REPORT *(continued)*

Credit Risk *(continued)*

The Bank's criticised loans and advances to customers amounted to €1,987m or 31.2% of total customer loans. The Bank's criticised loans have increased by €169m since 31 December 2012. 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 high levels of unemployment and reduced earnings which negatively affected borrowers' ability to repay loans.

Total impaired loans	**2013**	**2013**	2012	2012
	€m	**%**	€m	%
Impaired loans – Core	**1,228**	**19.3**	1,044	15.7
Impaired loans – Non Core	**10**	**0.2**	8	0.1
Total	**1,238**	**19.5**	1,052	15.8

The Bank's impaired loans are up €186m in the year to €1,238m (or 19.5% 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*

Loans neither past due nor impaired have decreased from 76.4% of loan balances in 2012 to 72.9% as at December 2013. The value of loans past due and/or impaired has increased from 23.6% in 2012 to 27.1% in 2013.

	2013				2012			
	Core	**Non-core**	**Total**	**%**	Core	Non-core	Total	%
	€m	**€m**	**€m**		€m	€m	€m	
Neither past due nor impaired	**4,630**	**9**	**4,639**	**72.9**	5,093	7	5,100	76.4
Past due but not impaired	**487**	**-**	**487**	**7.7**	518	1	519	7.8
Impaired – no provision	**13**	**-**	**13**	**0.2**	46	-	46	0.7
Impaired – provision held	**1,215**	**10**	**1,225**	**19.2**	998	8	1,006	15.1
Gross loans and advances	**6,345**	**19**	**6,364**	**100.0**	6,655	16	6,671	100.0
Provision for impairment	**(376)**	**(5)**	**(381)**		(241)	(3)	(244)	
Total loans and advances after provisions	**5,969**	**14**	**5,983**		6,414	13	6,427	

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

RISK MANAGEMENT REPORT ***(continued)***

Credit Risk* ***(continued)***

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.

	2013				2012			
	Core	**Non-core**	**Total**	**%**	Core	Non-core	Total	%
	€m	**€m**	**€m**		€m	€m	€m	
1 – 30 days	**274**	**-**	**274**	**56.3**	312	-	312	60.1
31 – 60 days	**108**	**-**	**108**	**22.2**	118	1	119	22.9
61 – 90 days	**78**	**-**	**78**	**16.0**	65	-	65	12.5
91 – 180 days	**27**	**-**	**27**	**5.5**	23	-	23	4.4
Total	**487**	**-**	**487**	**100.0**	518	1	519	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.

2013	**Loans & Advances**	**Impaired Loans & Advances**	**Impaired % of Loans**	**Individually Assessed**	**Collectively Assessed**	**Total Impairment Provision**	**Provision as % of impaired loans**
Residential	**6,364**	**1,238**	**19.5**	**335**	**46**	**381**	**30.8**
Total	**6,364**	**1,238**	**19.5**	**335**	**46**	**381**	**30.8**

2012	Loans & Advances	Impaired Loans & Advances	Impaired % of Loans	Individually Assessed	Collectively Assessed	Total Impairment Provision	Provision as % of impaired loans
Residential	6,671	1,052	15.8	200	44	244	23.2
Total	6,671	1,052	15.8	200	44	244	23.2

Global and domestic economic markets continued to experience difficulties throughout 2013 which impacted negatively on the Group’s lending portfolios.

The Bank’s income statement provision charge for loans and advances to customers was €137m or 2.2% of loan balances and included a specific provision charge of €135m and a collective provision charge of €2m. 96.4% of the charge related to owner-occupier residential mortgages with the remainder 3.6% for borrowers in the buy-to-let sector.

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RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Forbearance*

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

A forbearance agreement is entered into where the customer is in financial difficulty to the extent that they are unable to repay both the principal and interest in accordance with the original contract terms. Modifications to the original contract can be of a temporary (e.g. interest only) or permanent (e.g. term extension) nature and a loan is considered to be no longer a forborne loan once the modified terms and conditions have expired.

As we are still in the early stages of implementing advanced forbearance solutions, the sustainability of the individual forbearance measures will be reviewed and assessed over time. The impact on provisioning will also be reviewed.

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

The strategy is built on three key factors:
i) Segmentation – identifying customers in difficulty;
ii) Sustainability – customer assessment; and
iii) Suitable Treatment – identifying solutions.

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

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

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

- Voluntary sale for loss: a voluntary sale for loss solution will be considered where the loan is deemed to be unsustainable and the customer is agreeable to sell the property and put an appropriate agreement in place to repay any residual debt.

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

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Owner Occupier Mortgages	Total loans in forbearance		2013 Loans >90 days in arrears and/or impaired at period end	
	Number of loans	Balance €m	Number of loans	Balance €m
Temporary restructures				
Interest Only	1,035	155	322	52
Deferred Interest Scheme	5	2	1	-
Other	85	10	33	4
Temporary Restructures Sub-total	1,125	167	356	56
Permanent restructures				
Arrears capitalisation	1,756	229	901	113
Term extension	1,940	169	320	30
Sale for loss	15	1	13	1
Split mortgage	78	12	53	7
Permanent Restructures Sub-total	3,789	411	1,287	151
Total	4,914	578	1,643	207

Buy-to-let Mortgages	Total loans in forbearance		2013 Loans >90 days in arrears and/or impaired at period end	
	Number of loans	Balance €m	Number of loans	Balance €m
Temporary restructures				
Interest Only	7	1	4	-
Other	-	-	-	-
Temporary Restructures Sub-total	7	1	4	-
Permanent restructures				
Arrears capitalisation				
Term extension	8	1	-	-
Sale for loss	3	-	3	-
Permanent Restructures Sub-total	11	1	3	-
Total	18	2	7	-

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RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Total Mortgages	**Total loans in forbearance**		**2013** **Loans >90 days in arrears and/or impaired at period end**	
	Number of loans	**Balance €m**	**Number of loans**	**Balance €m**
Temporary restructures				
Interest Only	**1,042**	**156**	**326**	**52**
Deferred Interest Scheme	**5**	**2**	**1**	**-**
Other	**85**	**10**	**33**	**4**
Temporary Restructures Sub-total	**1,132**	**168**	**360**	**56**
Permanent restructures				
Arrears capitalisation	**1,756**	**229**	**901**	**113**
Term extension	**1,948**	**170**	**320**	**30**
Sale for loss	**18**	**1**	**16**	**1**
Split mortgage	**78**	**12**	**53**	**7**
Permanent Restructures Sub-total	**3,800**	**412**	**1,290**	**151**
Total	**4,932**	**580**	**1,650**	**207**

Owner Occupier Mortgages	Total loans in forbearance		2012 Loans >90 days in arrears and/or impaired at period end	
	Number of loans	Balance €m	Number of loans	Balance €m
Temporary restructures				
Interest Only	2,684	424	833	146
Deferred Interest Scheme	3	1	1	-
Other	168	21	76	10
Temporary Restructures Sub-total	2,855	446	910	156
Permanent restructures				
Arrears capitalisation	634	93	400	57
Term extension	1,948	167	271	22
Split mortgage	2	-	1	-
Permanent Restructures Sub-total	2,584	260	672	79
Total	5,439	706	1,582	235

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Buy-to-let Mortgages	Total loans in forbearance		2012 Loans >90 days in arrears and/or impaired at period end	
	Number of loans	Balance €m	Number of loans	Balance €m
Temporary restructures				
Interest Only	13	3	8	2
Other	1	-	-	-
Temporary Restructures Sub-total	14	3	8	2
Permanent restructures				
Arrears capitalisation	-	-	-	-
Term extension	7	1	-	-
Permanent Restructures Sub-total	7	1	-	-
Total	21	4	8	2

Total Mortgages	Total loans in forbearance		2012 Loans >90 days in arrears and/or impaired at period end	
	Number of loans	Balance €m	Number of loans	Balance €m
Temporary restructures				
Interest Only	2,697	427	841	148
Deferred Interest Scheme	3	1	1	-
Other	169	21	76	10
Temporary Restructures Sub-total	2,869	449	918	158
Permanent restructures				
Arrears capitalisation	634	93	400	57
Term extension	1,955	168	271	22
Split mortgage	2	-	1	-
Permanent Restructures Sub-total	2,591	261	672	79
Total	5,460	710	1,590	237

The types of forbearance measures that are currently considered for mortgage customers are interest only, arrears capitalisation, term extension, deferred interest scheme, split mortgage and other solutions such as combination of interest only and term extension. EBS has developed a Mortgage Arrears Resolution Strategy (“MARS”) for dealing with customers in difficulty or likely to be in difficulty. Of the total residential mortgage book of €6,364m, 9.1% or €580m are subject to forbearance measures as at 31 December 2013, compared to 10.6% as at 31 December 2012. €207m (35.7%) of the loans under forbearance were >90 days past due or impaired as at 31 December 2013, compared to 33.4% as at 31 December 2012.

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Analysis by Loan-to-value ('LTV') of Residential Mortgage Lending

	31 December 2013			31 December 2012		
Forbearance stock	**Owner Occupier**	**Buy-to-let**	**Total**	Owner Occupier	Buy-to-let	Total
	€m	**€m**	**€m**	€m	€m	€m
Less than 50%	**64**	**1**	**65**	52	-	52
50% - 70%	**64**	**-**	**64**	65	1	66
71% - 80%	**41**	**-**	**41**	45	-	45
81% - 90%	**46**	**-**	**46**	50	-	50
91% - 100%	**47**	**-**	**47**	55	1	56
101% - 120%	**90**	**-**	**90**	107	-	107
121% - 150%	**114**	**1**	**115**	164	1	165
Greater than 150%	**112**	**-**	**112**	168	1	169
Total	**578**	**2**	**580**	706	4	710

Credit profile of Residential Mortgages in Forbearance

Past due but not impaired

	31 December 2013			31 December 2012		
Forbearance stock	**Owner Occupier**	**Buy-to-let**	**Total**	Owner Occupier	Buy-to-let	Total
	€m	**€m**	**€m**	€m	€m	€m
0 - 30 days	**58**	**-**	**58**	57	-	57
31 - 60 days	**19**	**-**	**19**	31	-	31
61 - 90 days	**13**	**-**	**13**	13	-	13
91 - 180 days	**6**	**-**	**6**	7	-	7
181 - 365 days	**1**	**-**	**1**	-	-	-
Over 365 days	**-**	**-**	**-**	-	-	-
Total past due but not impaired	**97**	**-**	**97**	108	-	108

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Forbearance stock – Impaired

	31 December 2013			31 December 2012		
Forbearance stock	**Owner Occupier**	**Buy-to-let**	**Total**	Owner Occupier	Buy-to-let	Total
	€m	**€m**	**€m**	€m	€m	€m
Not Past Due	**44**	**-**	**44**	42	-	42
0 - 30 days	**19**	**-**	**19**	17	-	17
31 - 60 days	**15**	**-**	**15**	12	-	12
61 - 90 days	**12**	**-**	**12**	8	-	8
91 - 180 days	**36**	**-**	**36**	49	1	50
181 - 365 days	**32**	**-**	**32**	53	1	54
Over 365 days	**43**	**1**	**44**	48	-	48
Total past due but not impaired	**201**	**1**	**202**	229	2	231

Summary	**31 December 2013**			31 December 2012		
Past due but not impaired	**97**	**-**	**97**	108	-	108
Impaired	**201**	**1**	**202**	229	2	231
Neither past due nor impaired	**280**	**1**	**281**	369	2	371
Total forbearance stock	**578**	**2**	**580**	706	4	710

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

RISK MANAGEMENT REPORT (continued)

Credit Risk* *(continued)*

Residential Repossessions
The Bank held 16 properties at year end, representing a decrease of 1 compared with 2012 year end. The Bank disposed of 17 repossessed properties in 2013.

Residential Mortgages - Repossessions

2013						
Movements in residential repossessions	**Owner occupier**		**Buy to let**		**Total**	
	No. of properties	**Loan balance at repossession €m**	**No. of properties**	**Loan balance at repossession €m**	**No. of properties**	**Loan balance at repossession €m**
Opening stock 1 January 2013	**13**	**4**	**4**	**1**	**17**	**5**
Repossessions in 2013	**16**	**4**	**-**	**-**	**16**	**4**
Disposals	**(16)**	**(4)**	**(1)**	**(1)**	**(17)**	**(5)**
Closing stock 31 Dec 2013	**13**	**4**	**3**	**-**	**16**	**4**
Of which at 31 Dec 2013:						
Voluntary Surrenders	**12**	**-**	**-**	**-**	**12**	**-**
Enforcement of security	**4**	**-**	**-**	**-**	**4**	**-**
	16	**-**	**-**	**-**	**16**	**-**

Residential Mortgages - Repossessions

2012						
Movements in residential repossessions	Owner occupier		Buy to let		Total	
	No. of properties	Loan balance at repossession €m	No. of properties	Loan balance at repossession €m	No. of properties	Loan balance at repossession €m
Opening stock 1 January 2012	15	4	-	-	15	4
Repossessions in 2012	6	2	4	1	10	3
Disposals	(8)	(2)	-	-	(8)	(2)
Closing stock 31 Dec 2012	13	4	4	1	17	5
Of which at 31 Dec 2012:						
Voluntary Surrenders	4	-	4	-	8	-
Enforcement of security	2	-	-	-	2	-
	6	-	4	-	10	-

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Residential Mortgage Repossessions

Stock/Activity	Number of repossessions	Balance €m	Gross sales proceeds €m	Cost to sell €m	Loss on sale €m	Weighted Average LTV at sale %
2013						
Owner Occupier	**16**	**4**	**2**	**-**	**3**	**280**
Buy-to-let	**1**	**1**	**-**	**-**	**-**	**135**
Total repossessions	**17**	**5**	**2**	**-**	**3**	
2012						
Owner Occupier	8	2	1	-	2	353
Buy-to-let	-	-	-	-	-	-
Total repossessions	8	2	1	-	2	353

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 CSO Residential Property Price Index.

2013	**Owner Occupier €m**	**BTL €m**	**Total €m**
Less than 50%	**755**	**2**	**757**
50% - 70%	**723**	**1**	**724**
71% - 80%	**445**	**1**	**446**
81% - 90%	**438**	**-**	**438**
91% - 100%	**526**	**1**	**527**
101% - 120%	**1,108**	**2**	**1,110**
121% - 150%	**1,238**	**8**	**1,246**
Greater than 150%	**1,112**	**4**	**1,116**
Total	**6,345**	**19**	**6,364**

2012	Owner Occupier €m	BTL €m	Total €m
Less than 50%	712	-	712
50% - 70%	682	1	683
71% - 80%	404	1	405
81% - 90%	439	1	440
91% - 100%	471	-	471
101% - 120%	1,145	2	1,147
121% - 150%	1,377	6	1,383
Greater than 150%	1,425	5	1,430
Total	6,655	16	6,671

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

45.5% of the owner-occupier and 26.3% of the BTL mortgages (by exposure) were in positive equity at 31 December 2013. In terms of the total portfolio, 54.6% was in negative equity at 31 December 2013, an improvement from 59.4% at 31 December 2012 reflecting the improvment in residential property prices seen in Ireland in 2013. The weighted average indexed loan to value ratio for the total book was 104.9% as at 31 December 2013 whilst the indexed loan to value ratio for the >90 days past due or impaired book was higher at 127.9%.

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 ratios at 31 December 2013 and 2012.

2013	**Owner Occupier**	**BTL**	**Total**
	€m	**€m**	**€m**
Less than 50%	**646**	**1**	**647**
50% - 70%	**596**	**1**	**597**
71% - 80%	**361**	**1**	**362**
81% - 90%	**347**	**-**	**347**
91% - 100%	**401**	**1**	**402**
101% - 120%	**853**	**1**	**854**
121% - 150%	**863**	**3**	**866**
Greater than 150%	**563**	**1**	**564**
Total	**4,630**	**9**	**4,639**

2012	Owner Occupier	BTL	Total
	€m	€m	€m
Less than 50%	622	1	623
50% - 70%	568	1	569
71% - 80%	333	-	333
81% - 90%	366	1	367
91% - 100%	379	-	379
101% - 120%	935	1	936
121% - 150%	1,018	2	1,020
Greater than 150%	872	1	873
Total	5,093	7	5,100

Among loans neither past due nor impaired, 50.8% of the owner-occupier and 44.4% of the BTL mortgages were in positive equity at 31 December 2013. In terms of the total portfolio, 49.2% was in negative equity at 31 December 2013, reflecting the recent decline in residential property prices in Ireland.

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RISK MANAGEMENT REPORT (continued)

Credit Risk* *(continued)*

90 days past due or impaired*

The following tables profiles the LTV residential mortgage portfolio that was > 90 days past due and /or impaired by the indexed loan to value ratios at 31 December 2013 and 2012.

2013	**Owner Occupier €m**	**BTL €m**	**Total €m**
Less than 50%	**71**	**1**	**72**
50% - 70%	**85**	**-**	**85**
71% - 80%	**58**	**-**	**58**
81% - 90%	**57**	**-**	**57**
91% - 100%	**82**	**-**	**82**
101% - 120%	**171**	**1**	**172**
121% - 150%	**272**	**5**	**277**
Greater than 150%	**459**	**3**	**462**
Total	**1,255**	**10**	**1,265**

2012	Owner Occupier €m	BTL €m	Total €m
Less than 50%	53	-	53
50% - 70%	74	-	74
71% - 80%	45	-	45
81% - 90%	41	1	42
91% - 100%	60	-	60
101% - 120%	127	1	128
121% - 150%	237	3	240
Greater than 150%	430	3	433
Total	1,067	8	1,075

28.1% of the owner-occupier and 10.0% of the BTL mortgages were in positive equity at 31 December 2013. In terms of the total portfolio, 72.0% was in negative equity at 31 December 2013.

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RISK MANAGEMENT REPORT (continued)

Credit Risk* ***(continued)***

Residential Mortgage lending with Fair Value Collateral*
The property values used in the completion of the following LTV tables are determined with reference to the most recent valuation indexed to the CSO Residential Property Price Index.

Residential Mortgage Lending - Total

2013	**Owner Occupier €m**	**BTL €m**	**Total €m**
Fully Collateralised			
Less than 50%	**755**	**2**	**757**
50% - 70%	**723**	**1**	**724**
71% - 80%	**445**	**1**	**446**
81% - 90%	**438**	**-**	**438**
91% - 100%	**526**	**1**	**527**
Partially Collateralised			
Book Value	**3,458**	**14**	**3,472**
Value of Collateral	**2,660**	**10**	**2,670**
Total	**5,547**	**15**	**5,562**

2012	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	712	1	713
50% - 70%	682	1	683
71% - 80%	404	1	405
81% - 90%	439	1	440
91% - 100%	471	-	471
Partially Collateralised			
Book Value	3,947	12	3,959
Value of Collateral	2,966	9	2,975
Total	5,674	13	5,687

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RISK MANAGEMENT REPORT (continued)

Credit Risk* *(continued)*

Residential Mortgage Lending – Neither Past Due nor Impaired*
The following tables profile the residential mortgage portfolio that is neither past due nor impaired by the indexed LTV ratio's at 31 December 2013 and 2012.

Residential - Neither Past Due nor Impaired

2013	**Owner Occupier €m**	**BTL €m**	**Total €m**
Fully Collateralised			
Less than 50%	**646**	**1**	**647**
50% - 70%	**596**	**1**	**597**
71% - 80%	**361**	**1**	**362**
81% - 90%	**347**	**-**	**347**
91% - 100%	**401**	**1**	**402**
Partially Collateralised			
Book Value	**2,279**	**5**	**2,284**
Value of Collateral	**1,812**	**4**	**1,816**
Total	**4,163**	**8**	**4,171**

2012	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	622	1	623
50% - 70%	568	1	569
71% - 80%	333	-	333
81% - 90%	366	1	367
91% - 100%	379	-	379
Partially Collateralised			
Book Value	2,825	4	2,829
Value of Collateral	2,182	3	2,185
Total	4,450	6	4,456

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RISK MANAGEMENT REPORT (continued)

Credit Risk* *(continued)*

The following tables profile the residential mortgage portfolio that is past due not impaired by the indexed LTV ratio's at 31 December 2013 and 2012.

Residential Mortgage Lending – Past due not impaired*

2013	**Owner Occupier €m**	**BTL €m**	**Total €m**
Fully Collateralised			
Less than 50%	**39**	**-**	**39**
50% - 70%	**44**	**-**	**44**
71% - 80%	**27**	**-**	**27**
81% - 90%	**35**	**-**	**35**
91% - 100%	**45**	**-**	**45**
Partially Collateralised			
Book Value	**297**	**-**	**297**
Value of Collateral	**227**	**-**	**227**
Total	**417**	**-**	**417**

2012	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	38	-	38
50% - 70%	42	-	42
71% - 80%	27	-	27
81% - 90%	32	-	32
91% - 100%	33	-	33
Partially Collateralised			
Book Value	346	1	347
Value of Collateral	258	1	259
Total	430	1	431

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RISK MANAGEMENT REPORT (continued)

Credit Risk* *(continued)*

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 LTV ratios at 31 December 2013 and 2012.

Residential Mortgage Lending – 90 Days past due and/or impaired*

2013	**Owner Occupier €m**	**BTL €m**	**Total €m**
Fully Collateralised			
Less than 50%	**71**	**1**	**72**
50% - 70%	**85**	**1**	**86**
71% - 80%	**58**	**-**	**58**
81% - 90%	**57**	**-**	**57**
91% - 100%	**82**	**-**	**82**
Partially Collateralised			
Book Value	**902**	**8**	**910**
Value of Collateral	**635**	**6**	**641**
Total	**988**	**8**	**996**

2012	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	53	-	53
50% - 70%	74	-	74
71% - 80%	45	-	45
81% - 90%	41	1	42
91% - 100%	60	-	60
Partially Collateralised			
Book Value	794	7	801
Value of Collateral	540	5	545
Total	813	6	819

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RISK MANAGEMENT REPORT (continued)

Credit Risk* ***(continued)***

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 LTV ratios at 31 December 2013 and 2012.

Residential Mortgage Lending– Impaired*

2013	**Owner Occupier €m**	**BTL €m**	**Total €m**
Fully Collateralised			
Less than 50%	**70**	**1**	**71**
50% - 70%	**83**	**-**	**83**
71% - 80%	**57**	**-**	**57**
81% - 90%	**56**	**-**	**56**
91% - 100%	**80**	**-**	**80**
Partially Collateralised			
Book Value	**882**	**9**	**891**
Value of Collateral	**621**	**6**	**627**
Total	**967**	**7**	**974**

2012	Owner Occupier €m	BTL €m	Total €m
Fully Collateralised			
Less than 50%	52	-	52
50% - 70%	72	-	72
71% - 80%	44	-	44
81% - 90%	41	1	42
91% - 100%	59	-	59
Partially Collateralised			
Book Value	776	7	783
Value of Collateral	528	5	533
Total	796	6	802

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RISK MANAGEMENT REPORT (continued)

Credit Risk* ***(continued)***

The following table profiles the Republic of Ireland residential mortgage book and impaired residential mortgage book at 31 December 2013 and 2012 by year of origination.

Residential Mortgages by year of origination*

2013	Residential Mortgage Loan Book		Loans >90 days in arrears but not impaired at period end		Loans classified as impaired at period end		Loans >90 days in arrears and/or impaired at period end	
Total	**Number of loans**	**Balance €m**	**Number of loans**	**Balance €m**	**Number of loans**	**Balance €m**	**Number of loans**	**Balance €m**
1996 and before	**3,446**	**94**	**4**	**-**	**339**	**16**	**343**	**16**
1997	**1,026**	**31**	**1**	**-**	**95**	**4**	**96**	**4**
1998	**1,064**	**38**	**1**	**-**	**109**	**6**	**110**	**6**
1999	**1,286**	**51**	**3**	**-**	**143**	**11**	**146**	**11**
2000	**1,463**	**84**	**2**	**-**	**167**	**14**	**169**	**14**
2001	**1,818**	**136**	**6**	**1**	**197**	**18**	**203**	**19**
2002	**2,504**	**218**	**7**	**1**	**252**	**26**	**259**	**27**
2003	**2,844**	**242**	**3**	**1**	**384**	**38**	**387**	**39**
2004	**3,324**	**312**	**7**	**1**	**430**	**52**	**437**	**53**
2005	**4,893**	**505**	**13**	**1**	**666**	**97**	**679**	**98**
2006	**7,920**	**1,166**	**34**	**6**	**1,391**	**263**	**1,425**	**269**
2007	**7,533**	**1,188**	**47**	**9**	**1,751**	**331**	**1,798**	**340**
2008	**7,072**	**1,042**	**26**	**4**	**1,556**	**263**	**1,582**	**267**
2009	**4,642**	**590**	**11**	**1**	**523**	**68**	**534**	**69**
2010	**4,553**	**614**	**11**	**2**	**223**	**30**	**234**	**32**
2011	**429**	**53**	**-**	**-**	**3**	**1**	**3**	**1**
2012	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
2013	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**-**
Total	**55,817**	**6,364**	**176**	**27**	**8,229**	**1,238**	**8,405**	**1,265**

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

RISK MANAGEMENT REPORT (continued)

Credit Risk* ***(continued)***

2012	Residential Mortgage Loan Book		Loans >90 days in arrears but not impaired at period end		Loans classified as impaired at period end		Loans >90 days in arrears and/or impaired at period end	
Total	Number of loans	Balance €m	Number of loans	Balance €m	Number of loans	Balance €m	Number of loans	Balance €m
1996 and before	4,297	114	6	-	328	16	334	16
1997	1,103	36	1	-	87	4	88	4
1998	1,220	44	4	-	97	5	101	5
1999	1,391	60	1	-	129	10	130	10
2000	1,557	94	4	-	137	11	141	11
2001	1,912	148	4	-	166	15	170	15
2002	2,657	240	5	-	221	23	226	23
2003	3,091	261	10	1	329	32	339	33
2004	3,479	334	14	2	376	45	390	47
2005	5,098	533	13	2	590	88	603	90
2006	8,231	1,215	25	4	1,136	219	1,161	223
2007	7,675	1,223	32	5	1,507	288	1,539	293
2008	7,364	1,073	32	5	1,361	230	1,393	235
2009	4,798	609	14	2	394	49	408	51
2010	4,677	632	14	2	124	17	138	19
2011	437	55	-	-	2	-	2	-
2012	-	-	-	-	-	-	-	-
Total	58,987	6,671	179	23	6,984	1,052	7,163	1,075

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

RISK MANAGEMENT REPORT (continued)

Credit Risk* ***(continued)***

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

The following table analyses gross loans to customers by maturity and interest rate sensitivity. Approximately 6.8% of Bank's mortgage portfolio is provided on a fixed rate basis. The Bank has outsourced the measurement and reporting management of its interest rate risk to AIB Group Asset and Liability Management team ('GALM') . GALM measures and reports 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 Banks' Management team monitors these risks at Bank level and are responsible for ensuring that the Banks' policy is adhered to.

Loans and advances to customers

	Fixed €m	Variable €m	Total €m	Within 1 year €m	After 1 year but within 5 years €m	After 5 years €m	Total €m
2013	**431**	**5,933**	**6,364**	**1,255**	**94**	**5,015**	**6,364**
2012	1,038	5,633	6,671	1,067	93	5,511	6,671

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) and 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 2013 (2012: Nil).

Treasury assets and derivatives*
Treasury assets consist of cash and balances with central banks, derivative financial instruments, available-for-sale, 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.

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

RISK MANAGEMENT REPORT (continued)

Credit Risk* *(continued)*

	Derivatives €m	Loans & Advances to Credit Institutions €m
2013		
Balances at 31 December 2013	**33**	**89**
Aaa	**-**	**-**
Aa3 to Aa1	**-**	**-**
A3 to A1	**-**	**89.7%**
Lower than A3	**100%**	**10.3%**
Unrated	**-**	**-**
2012		
Balances at 31 December 2012	35	128
Aaa	-	-
Aa3 to Aa1	-	-
A3 to A1	-	23.5%
Lower than A3	100%	76.5%
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. Treasury Assets are monitored on a daily basis.

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 €m	Over 1 month to 3 months €m	Over 3 months to 6 months €m	Over 6 months to 1 year €m	1 to 2 years €m	Over 3 years €m	Total €m
31 December 2013							
Financial Liabilities							
Deposits by credit institutions	**2,978**	**-**	**-**	**-**	**-**	**-**	**2,978**
Derivative financial instruments	**-**	**-**	**-**	**-**	**-**	**33**	**33**
Debt securities in issue	**1**	**4**	**400**	**550**	**450**	**1,400**	**2,805**
	2,979	**4**	**400**	**550**	**450**	**1,433**	**5,816**

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

RISK MANAGEMENT REPORT (continued)

Credit Risk* ***(continued)***

	Up to 1 month €m	Over 1 month to 3 months €m	Over 3 months to 6 months €m	Over 6 months to 1 year €m	1 to 2 years €m	Over 3 years €m	Total €m
31 December 2012							
Financial Liabilities							
Deposits by credit institutions	3,254	-	-	-	-	-	3,254
Derivative financial instruments	-	-	-	-	-	36	36
Debt securities in issue	1	4	-	400	700	2,050	3,155
	3,255	4	-	400	700	2,086	6,445

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.

Interest rate risk*

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.

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

RISK MANAGEMENT REPORT *(continued)*

Credit Risk* *(continued)*

Interest rate sensitivity gap analysis 2013*

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 €m	Over 3 months but not more than 12 months €m	Over 1 year but not more than 5 years €m	Over 5 years €m	Non Interest Bearing €m	Trading €m	Total €m
2013 Non-trading book Assets							
Loans and advances to credit institutions	89	-	-		-	-	89
Loans and advances to customers	5,941	142	268	13	(381)	-	5,983
Other assets					25	33	58
Total assets	6,030	142	268	13	(355)	33	6,130
Liabilities							
Debt securities in issue	2,694	-	-	-	-	-	2,694
Deposits by credit institutions	2,978	-	-	-	-	-	2,978
Other liabilities	-	-	-	-	1	33	34
Total shareholders' equity	-	-	-	-	424	-	424
Total liabilities	5,672	-	-	-	425	33	6,130
Interest rate sensitivity gap	358	142	268	13	(781)	-	-
Cumulative gap	358	500	768	781	-	-	-

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

RISK MANAGEMENT REPORT (continued)

Credit Risk* ***(continued)***

Interest rate sensitivity gap analysis 2012

	Not more than 3 months €m	Over 3 months but not more than 12 months €m	Over 1 year but not more than 5 years €m	Over 5 years €m	Non Interest Bearing €m	Trading €m	Total €m
2012							
Non-trading book							
Assets							
Loans and advances to credit institutions	128	-	-	-	-	-	128
Loans and advances to customers	6,047	393	208	28	(249)	-	6,427
Other assets	-	-	-	-	24	35	59
Total assets	6,175	393	208	28	(225)	35	6,614
Liabilities							
Debt securities in issue	2,969	-	-	-	-	-	2,969
Deposits by credit institutions	3,254	-	-	-	-	-	3,254
Other liabilities	-	-	-	-	2	36	38
Total shareholders' equity	-	-	-	-	353	-	353
Total liabilities	6,223	-	-	-	355	36	6,614
Interest rate sensitivity gap	(48)	393	208	28	(580)	(1)	-
Cumulative gap	(48)	345	553	581	1	-	-

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.

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 Group historically conducted daily stress testing on the Banking Book Portfolio, evaluating the exposure of the Group to a parallel interest rate shift of 100 bps and a series of yield curve twist tests. The results of these stress tests are presented to the EBS Management team on a monthly basis. Stress testing methodologies are now aligned and prepared on an AIB p.l.c. basis.

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

RISK MANAGEMENT REPORT (continued)

Credit Risk* *(continued)*

The tables below provide an analysis of the Bank's sensitivity to an increase or decrease in Euribor rates:

		100 bps parallel shift (increase/decrease) 2013 €m		2012 €m
Banking book portfolio				
Average for the period	**- / +**	**1**	- / +	1
Maximum for the period	**- / +**	**2**	- / +	3
Minimum for the period	**- / +**	**-**	- / +	-

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 the Group in conjunction with AIB Group Treasury.

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

Deloitte.

Deloitte & Touche
Chartered Accountants &
Registered Auditors

INDEPENDENT AUDITORS REPORT TO THE MEMBERS OF EBS MORTGAGE FINANCE

We have audited the financial statements (''financial statements'') of EBS Mortgage Finance (the "Bank") for the year ended 31 December 2013 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, Statement of Changes in Equity, the Statement of Cashflows and the related notes 1 to 21. The financial reporting framework that has been applied in their preparation is Irish law and International Financial Reporting Standards (IFRSs) as adopted by the European Union.

This report is made solely to the company's members, as a body, in accordance with section 193 of the Companies Act 1990. Our audit work has been undertaken so that we might state to the company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the company and the company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of directors and auditor

As explained more fully in the Statement of Directors' Responsibilities Statement set out on page 10 the directors are responsible for the preparation of the financial statements giving a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with Irish law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

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

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Bank's affairs as at 31 December 2013 and of its loss for the year then ended; and

- have been properly prepared in accordance with the Companies Acts 1963 to 2013.

Continued on next page/

Members of
Deloitte Touche Tohmatsu

Deloitte.

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INDEPENDENT AUDITORS REPORT TO THE MEMBERS OF EBS MORTGAGE FINANCE

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

- We have obtained all the information and explanations which we consider necessary for the purposes of our audit.
- In our opinion proper books of accounts have been kept by the Bank.
- The financial statements are in agreement with the books of account.
- In our opinion the information given in the directors' report is consistent with the financial statements.
- The net assets of the company, as stated in the Statement of Financial Position are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2013 a financial situation which under Section 40(1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the company.

Matters on which we are required to report by exception

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

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

24 March 2014

ACCOUNTING POLICIES

1.1 Reporting Entity

EBS Mortgage Finance (the 'Bank') was incorporated in the Republic of Ireland on 30 October 2008 as a public 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 2001 and 2007. 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 1.

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 'IFRSs') as issued by the International Accounting Standards Board ('IASB') and International Financial Reporting Standards as adopted by the European Union ("EU") and applicable for the year ended 31 December 2013. The accounting policies have been consistently applied by the company 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 2013 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

Functional and presentation currency

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

Basis of measurement

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

The 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 equity together with the related notes. These notes also include financial instrument related disclosures which are required by IFRS 7 and revised IAS 1, contained in the Risk Management section of this annual financial report. The relevant information on those pages is identified as forming an integral part of the audited financial statements.

ACCOUNTING POLICIES *(continued)*

Basis of preparation *(continued)*

Use of estimates and judgements
The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of certain assets, liabilities, revenues, expenses and disclosures of contingent assets and liabilities. The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Since management's judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. The estimates and underlying assumptions are received on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The estimates that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of loan impairment; the recoverability of deferred tax and determination of the fair value of certain financial assets and liabilities. In addition, the designation of financial assets and financial liabilities has a significant impact on their income statement treatment and could have a significant impact on reported income. A description of these estimates and judgements is set out in section 1.15 of the accounting policies.

Adoption of new accounting standards
The following amendments to standards have been adopted by the Bank during the year ended 31 December 2013:

<u>(i) Amendments to IAS 1 – Presentation of Items in Other Comprehensive Income</u>
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 adoption of these amendments has resulted in a change in the presentation of other comprehensive income.

<u>(ii) IFRS 13 Fair Value Measurement</u>
This standard which is effective from 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. The standard 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 is required for both financial and non-financial assets and liabilities. The adoption of this standard has resulted in additional disclosures.

Other amendments, resulting from improvements to IFRSs which the Group adopted in 2013, did not have any impact on the accounting policies, financial position or performance of the Group.

1.4 Net Trading Income/Expense
Net trading expense comprises gains less losses relating to trading assets and trading liabilities and includes all realised and unrealised fair value changes.

1.5 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.

ACCOUNTING POLICIES *(continued)*

1.5 Income Tax, including Deferred Income Tax (continued)
Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

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

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

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

1.6 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.

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. An IBNR impairment provision represents an interim step pending the identification of impairment losses on an individual asset in a group of financial assets. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

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

ACCOUNTING POLICIES *(continued)*

1.6 Impairment of Financial Assets *(continued)*

Collective evaluation of impairment (continued)
Future cashflow for a group of financial assets that are collectively evaluated for impairment is estimated 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 cashflows 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.

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

Forbearance
A forbearance agreement is entered into where the customer is in financial difficulty to the extent that they are unable to repay both the principal and interest on their loan in accordance with their original contract. Following an assessment of the customer's repayment capacity, a potential solution will be determined from the options available. There are a number of different types of forbearance options including interest and/or arrears capitalisation, interest rate adjustments, payment holidays, term extensions and equity swaps.

ACCOUNTING POLICIES *(continued)*

1.6 Impairment of Financial Assets *(continued)*

Forbearance (continued)

Forbearance mortgage loans, as for any loan classified as impaired, may be upgraded from impaired status.In this regard, the borrower is required to display a satisfactory performance following the period of restructure of the loan, comprising a period of typically twelve months consecutive payments of full principal and interest and typically, the upgrade would initially be to Watch/Vulnerable grades. If a loan is upgraded from impaired, it will be included in the Bank's collective assessment for IBNR provisions.

Where the terms on a renegotiated loan which has been subject to an impairment provision differ substantially from the original loan terms either in a quantitative or qualitative analysis, the original loan is derecognised and a new loan is recognised at fair value.

Any difference between the carrying amount of the loan and the fair value of the new renegotiated loan terms is recognised in the Income Statement. Interest accrues on the new loan based on the current market rates in place at the time of renegotiation.

Non-forbearance renegotiation

Occasionally, the Bank may temporarily amend the contractual repayments term on a loan (e.g. payment moratorium) for a short period of time due to a temporary change in the life circumstances of the borrower. Because such events are not directly linked to repayment capacity, these amendments are not considered forbearance. The changes in expected cash flows are accounted for under IAS 39, paragraph AG 8, i.e. the carrying amount of the loan is adjusted to reflect the revised estimated cash flows which are discounted at the original effective interest rate. Any adjustment to the carrying amount of the loan is reflected in the income statement as interest income/expense.

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

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

Collateralised financial assets - Repossessions

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, costs for obtaining and settling the collateral, and whether or not foreclosure is probable.

For loans which are impaired, the Group may repossess collateral previously pledged as security in order to achieve an orderly realisation of the loan. AIB will then offer this repossessed collateral for sale. However, if the Group believes the proceeds of the sale will comprise only part of the recoverable amount of the loan with the customer remaining liable for any outstanding balance, the loan continues to be recognised and the repossessed asset is not recognised. However, if the Group believes that the sale proceeds of the asset will comprise all, or substantially all, of the recoverable amount of the loan, the loan is derecognised and the acquired asset is accounted for in accordance with the applicable accounting standard. Any further impairment of the repossessed asset is treated as an impairment of the relevant asset and not as an impairment of the original loan.

ACCOUNTING POLICIES *(continued)*

1.6 Impairment of Financial Assets *(continued)*

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 cumulative numbers of days that a missed payment is overdue. Past due days commence from the close of business on the day on which a payment is due but not received. When a borrower is past due, the entire exposure is reported as past due, rather than the amount of any excess or arrears.

1.7 Determination of Fair Value of Financial Instruments
The best evidence of fair value is quoted prices in an active market. The absence of quoted prices increases reliance on valuation techniques and requires the use of judgement in the estimation of fair value. This judgement includes but is not limited to: evaluating available market information; determining the cash flows for the instruments; identifying a risk free discount rate and applying an appropriate credit spread.The bank considers the impact of non-performance risk when valuing its financial liabilities.

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

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

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

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

ACCOUNTING POLICIES *(continued)*

1.7 Determination of Fair Value of Financial Instruments *(continued)*

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 and counterparty risk when valuing its derivative liabilities.

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

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

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

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

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

The choice of contributors, the quality of market data used for pricing, and the valuation techniques used are all subject to internal review and approval procedures.

ACCOUNTING POLICIES *(continued)*

1.7 Determination of Fair Value of Financial Instruments *(continued)*

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

1.8 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. 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 bank 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 adjusted for direct and incremental transaction costs and are subsequently carried on an amortised cost basis.

ACCOUNTING POLICIES *(continued)*

1.9 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 with the related transaction costs 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.

1.10 Intangible Assets
Computer software is stated at cost and 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.

1.11 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

ACCOUNTING POLICIES *(continued)*

1.11 Derivatives and Hedge Accounting *(continued)*

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

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

The Bank discontinues hedge accounting when:
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.

1.12 Collateral
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.

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.

ACCOUNTING POLICIES *(continued)*

1.12 Collateral *(continued)*

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.

1.13 Shareholders’ equity

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.

General reserves

Reserve amount kept by the Bank out of its profits for future purposes.

1.14 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.

1.15 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. 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.

ACCOUNTING POLICIES *(continued)*

1.15 Critical Accounting Judgements and Estimates *(continued)*

Loan Impairment

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.

The Bank considers that the provisions for loan impairments at 31 December 2013 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.

The estimation of loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local and international economic climates, conditions in various industries to which the Bank is exposed and other external factors such as legal and regulatory requirements. Credit risk is identified, assessed and measured through the use of credit rating and scoring tools. Special attention is paid to lower quality rated loans and when appropriate, loans are transferred to specialist units to help avoid default, or where in default, to help minimise loss.

The management process for the identification of loans requiring provision is underpinned by independent tiers of review. Credit quality and loan loss provisioning are independently monitored by credit and risk management on a regular basis. The Bank assess and approves its provisions and provision adequacy on a quarterly basis. These provisions are in turn reviewed and approved by the AIB Group Credit Committee on a quarterly basis with ultimate Group levels being approved by the Audit Committee and the Board. Key assumptions underpinning the estimates as if colletive and INBR provisioning are assessed annually with the benefit of experience.

Specific provisions

A specific provision is made against problem loans when, in the judgement of management, the estimated repayment realisable from the obligor, including the value of any security available, is likely to fall short of the amount of principal and interest outstanding on the obligor’s loan account. The amount of the specific provision made in the Bank’s financial statements is intended to cover the difference between the assets’ carrying value and the present value of estimated future cash flows discounted at the assets’ original effective interest rates. Specific provisions are created for cases that are individually significant (i.e. above certain thresholds), and also collectively for assets that are not individually significant.

The amount of specific provision required on an individually assessed loan is highly dependent on estimates of the amount of future cash flows and their timing. Individually insignificant impaired loans are collectively evaluated for impairment. As this process is model driven, the total amount of the Bank’s impairment provisions on these loans is somewhat uncertain as it may not totally reflect the impact of the prevailing market conditions.

Changes in the estimate of the value of security and the time it takes to receive those cash flows could have a significant effect on: the amount of impairment provisions required; on the income statement expense; and on the statement of financial position. For example, in assessing the value of residential property held as collateral for impaired mortgage loans in Ireland, the Bank uses a ‘peak-to-trough’ house price decline of 55% as a base. In certain circumstances, realisation costs of 4% to 15% are also deducted.

ACCOUNTING POLICIES *(continued)*

1.15 Critical Accounting Judgements and Estimates *(continued)*

For larger impaired loans (individually significant) other factors such as recent transactional evidence and/or local knowledge are considered, which can result in higher discounts to collateral values. CSO statistics for December 2013 outline a 'peak-to-trough' decline of 46.4% for residential property, nationally. If prices were to decline by a further 2% from the Bank 's assumed values (resulting in a cumulative peak to trough fall of 57%) and this decline fell directly through to the collateral values of its impaired mortgage loans in Ireland, the additional impairment provision impact would be in the range of approximately €11 million to €13 million.

Incurred but not reported provisions
Incurred but not reported ("IBNR") provisions are also maintained to cover loans which are impaired at the reporting date and, while not specifically identified, are known from experience to be present in any portfolio of loans. IBNR provisions are maintained at levels that are deemed appropriate by management having considered: credit grading profiles and grading movements; historic loan loss rates; changes in credit management; procedures, processes and policies; levels of credit management skills; local and international economic climates; portfolio sector profiles/industry conditions; and current estimates of loss in the portfolio.

The total amount of impairment loss in the Bank's non-impaired portfolio and therefore, the adequacy of the IBNR allowance, is inherently uncertain. There may be factors in the portfolio that have not been a feature of the past and changes in credit grading profiles and grading movements may lag the change in the credit profile of the customer. In addition, current estimates of loss within the non-impaired portfolio and the period of time it takes following a loss event for an individual loan to be recognised as impaired ('emergence period') are subject to a greater element of estimation due to the speed of change in the economies in which the Bank operates and the unprecedented market conditions. Furthermore, the potential impact of customers' attitudes to debt obligations following new Personal Insolvency legislation, which took effect in December 2013, may impact the level of impairment provisions required.

Forbearance
The Bank has developed a number of forbearance strategies for both short-term and longer-term solutions to assist customers experiencing financial difficulties. The forbearance strategies involve modifications to contractual repayment terms in order to improve the collectability of outstanding debt, to avoid default, and where relevant, to avoid repossessions. The longer-term advanced forbearance strategies are currently in the process of being rolled to relevant residential mortgage customers in Ireland, accordingly. Where level of forbearance are significant, higher levels of judgement and estimation uncertainty are involved in determining their effects on impairment provisions. Further information on forbearance strategies is set in the 'Risk Management Report' section of these financial statements.

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 or expense on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

ACCOUNTING POLICIES *(continued)*

1.15 Critical Accounting Judgements and Estimates *(continued)*

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

The calculation takes into account all fees, including those for early redemption, 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 fair value hedges which are recognised in interest income or interest expense.

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

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

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 the 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.

Among this evidence, the principal positive factors include the:

- absence of any expiry dates for Irish tax losses;
- non-enduring nature of the loan impairments at levels which resulted in recent years' losses;
- generation of operating profits before provisions in recent years; and
- return to profitability within the Bank's internal medium-term financial plan and the ability to grow profits thereafter.

The Board considered negative evidence and the inherent uncertainities in any financial assumptions and projections, including;

- the potential instability in the eurozone and global economies over an extended period; and
- recent taxation changes (including Bank Levy) and the likelihood of future developments and their impact on profitability and utilisation.

ACCOUNTING POLICIES *(continued)*

1.15 Critical Accounting Judgements and Estimates *(continued)*

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 the Bank's medium-term financial plan and will achieve profits producing a sustainable market-range return on equity in the long term. In the absence of any expiry date for tax losses in Ireland, the Bank therefore believes that it is more likely than not that there will be future profits against which to use the tax losses. The Bank has carried out an exercise to determine the likely number of years required to utilise the deferred tax, which indicates the deferred tacx asset will be fully utilised with 4 years.

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

Going concern

The financial statements for the year ended 31 December 2013 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment .The period of assessment used by the Directors is twelve months from the date of approval of these annual financial statements. The Bank is dependent on its ultimate parent Allied Irish Bank p.l.c. for continued funding and is therefore dependent on the going concern of the ultimate parent.

In making its assessment, the Directors of AIB Group have considered a wide range of information relating to present and future conditions. These have included financial plans covering the period 2014 to 2016 approved by the Board in December 2013, the restructuring plan submitted to the European Commission in September 2012, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios. In addition, the Directors of AIB Group have considered the commitment of support provided to AIB by the Irish Government. The Directors have also considered the risk factors which could materially affect the Group's future business performance and profitability.

Furthermore, the Directors of AIB Group have considered the outlook for the Irish economy, taking into account such factors as the successful exit by the Irish Government from the three-year bailout programme in December 2013 without a back-up credit line, the forecast expansion of the economy and the forecast fall in unemployment rates, in 2014. The forecast turnaround in the economy is supported by various economic indicators such as a modest growth in economic output and reduced unemployment levels together with increasing consumer confidence and a stabilisation of house prices, particularly in Dublin, during 2013.

The Directors of AIB Group have also considered the outlook for the eurozone and UK economies which are slowly emerging from recession. In the EU, following the sovereign and bank debt crises, the actions taken at an EU level lead to a marked easing of the crises and improvement of conditions in eurozone financial markets since the second half of 2012. The various support measures adopted for the euro since the beginning of 2011 and the pronouncements of the ECB demonstrate the strong commitment of EU institutions and the euro area Member States to do whatever is necessary to preserve the euro. In addition, the UK economy in which the Group has significant interests has returned to growth following a period of stagnation similar to the eurozone.

The Irish Government, as AIB's principal shareholder, has confirmed its recognition of AIB as a 'Pillar Bank', given its key role in supporting the Irish economy. In support of this role, it has ensured that AIB has been sufficiently capitalised to meet the capital targets set by the Central Bank through its 2011 PCAR and PLAR assessment.

ACCOUNTING POLICIES *(continued)*

1.15 Critical Accounting Judgements and Estimates *(continued)*

The Directors of AIB Group have reviewed the capital and financial plans for the 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.

In relation to liquidity and funding, the Directors of AIB Group are satisfied, based on AIB's position as one of the two 'Pillar Banks' 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.

Conclusion
On the basis of the above, the Directors of AIB Group 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 have also considered the Banks' financial plan approved by the Board in March 2014 which shows a return to profitability on 2014 together with the Bank's robust capital position.

On the basis of the continued availability of funding from AIB, the Banks' financial plan and robust capital position, the Directors of the Bank consider that it is appropriate to prepare the financial statements of the Bank on a going concern basis at this time.

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

The Bank is currently considering the impacts of these amendments. The new accounting standards and amendments which are more relevant to the Group are detailed below.

(a) Amendments to *IAS 36 Impairment of Assets* on Recoverable Amount Disclosures for Non-Financial Assets.
<u>Nature of Change</u>
As part of the development of IFRS 13 *Fair Value Measurement*, the IASB amended IAS 36 to require disclosures about the recoverable amount of impaired assets. The amendments published in May 2013 clarify that the scope of these disclosures is limited to the recoverable amount of impaired assets that is based on fair value less costs of disposal. The amendments require an entity to disclose:

- the level of the fair value hierarchy within which the fair value of the asset is categorised;
- a description of the valuation technique(s) used to measure the fair value less costs of disposal, where the fair value measurement is categorised within Level 2 or Level 3 of the fair value hierarchy;
- the key assumptions which management has based its determination of fair value less costs of disposal, where the fair value measurement is categorised within Level 2 or Level 3 of the fair value hierarchy; and
- the discount rates used to determine current and previous impairments where the recoverable amount of impaired assets, based on fair value less costs of disposal, was measured using a present value technique.
-

The amendment is still subject to EU endorsement.

<u>IASB Effective Date</u>
Annual periods beginning on or after 1 January 2014

ACCOUNTING POLICIES *(continued)*

1.16 Prospective Accounting Changes *(continued)*

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

Nature of Change

The amendment to *IAS 39 Financial Instruments: Recognition and Measurement* provides an exception to the requirement to discontinue hedge accounting where a hedging derivative is novated, provided certain criteria are met.

The amendment applies to novations:

- which arise due to laws or regulations, or the introduction of laws or regulations;
- where the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties; and
- that did not result in changes to the terms of the original derivative except the changes directly attributable to the change in counterparty to achieve clearing.

All of the above criteria must be met to continue hedge accounting under this exception.

The amendment is still subject to EU endorsement.

IASB Effective Date

- Annual periods beginning on or after 1 January 2014

(c) Annual improvements to IFRSs 2010–2012 cycle

Nature of Change

In December 2013, the IASB issued Annual Improvements to IFRSs 2010 – 2012 Cycle. The amendments to standards under the annual improvements process are primarily to remove inconsistencies and clarify wording.

The amendments are to seven International Financial Reporting Standards. The relevant amendment is:

IFRS 13 *Fair Value Measurement*

The amendment clarifies that amendments to *IFRS 9 Financial Instruments* and *IAS 39 Financial Instruments: Recognition and Measurement* by IFRS 13 did not remove the ability to measure short - term receivables and payables with no stated interest rate at invoice amounts without discounting, when the effect of not discounting is immaterial.

The above amendment is not expected to have a significant impact on reported results or disclosures.

The amendments are still subject to EU endorsement.

IASB Effective Date

Annual periods beginning on or after 1 July 2014

(d) Annual improvements to IFRSs 2011–2013 cycle

Nature of Change

In December 2013, the IASB issued *Annual Improvements to IFRSs 2011– 2013 Cycle*. The amendments to standards under the annual improvements process are primarily to remove inconsistencies and clarify wording. The relevant amendment to the Bank is:

IFRS 13 *Fair Value Measurement*

The amendment clarifies that the scope of the portfolio exception defined in paragraph 52 of IFRS 13 includes all contracts accounted for within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*, irrespective of whether they meet the definition of financial assets or financial liabilities as defined in IAS 32 *Financial Instruments: Presentation*.

ACCOUNTING POLICIES *(continued)*

1.16 Prospective Accounting Changes *(continued)*

The above amendment is not expected to have a significant impact on reported results or disclosures.

The amendments are still subject to EU endorsement.

<u>IASB Effective Date</u>
Annual periods beginning on or after 1 July 2014.

(e) IFRS 9 *Financial Instruments*
<u>Nature of Change</u>
IFRS 9 will ultimately replace IAS 39 *Financial Instruments: Recognition and Measurement*. This project consists of three date removed until main phases:

Phase 1: Classification and measurement
In November 2009, the IASB issued IFRS 9 Financial Instruments covering classification and measurement of financial assets. The new standard aims 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. The basis of classification depends on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets.
The IASB reissued IFRS 9 in October 2010. The revised standard incorporated new requirements on accounting for financial liabilities, and carried over the requirements for derecognition of financial assets and liabilities from IAS 39.

Phase 2: Impairment methodology
The IASB published the Exposure Draft *Financial Instruments: Expected Credit Losses* in March 2013. The comment period closed on 5 July 2013 and redeliberations are on-going.

Phase 3: Hedge accounting
In November 2013, the IASB issued an update to IFRS 9 *Financial Instruments* (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39). This includes new hedge accounting requirements and some related amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures*.

This phase replaces the rule-based hedge accounting requirements in IAS 39 Financial Instruments: Recognition and Measurement to more closely align the accounting with risk management activities. The objective of this phase is to improve the ability of investors to understand risk management activities and to assess the amounts, timing and uncertainty of future cash flows. This update to IFRS 9 does not deal with macro hedging which is scheduled for a Discussion Paper in 2014.

The main areas of change to hedge accounting are as follows:
- Risk component – this may be designated as the hedged item, for both financial and non-financial items, if the risk component is separately identifiable and reliably measurable;
- Hedge effectiveness testing – the 80-125% range is replaced by an objectives-based test which focuses on the economic relationship between the hedged item and the hedging instrument and the effect of credit risk on the economic relationship;
- Costs of hedging – the time value of an option, the forward element of a forward contract and any foreign currency basis spread may be excluded from the designation of a financial instrument as the hedging instrument and accounted for as costs of hedging;
- Groups of items – more designations of groups of items as the hedged item are possible;
- Disclosures – more extensive disclosures are required.

ACCOUNTING POLICIES *(continued)*

1.16 Prospective Accounting Changes *(continued)*

IFRS 9 (2013) also includes two changes resulting from other phases of the IASB's financial instruments project:

- IFRS 9 requires that changes in the fair value of an entity's own debt caused by changes in its own credit quality to be recognised in other comprehensive income rather than in profit or loss. Under a 'fast-track' option, entities can apply these requirements of IFRS 9 early without applying the other IFRS 9 requirements at the same time.

Since some significant aspects of the standard have yet to be finalised, namely, impairment and macro hedging, it is impracticable for the Bank to quantify the impact of IFRS 9 at this stage. However, the implementation and the impact of the standard are likely to be significant.

The new standard is subject to EU endorsement

<u>IASB Effective Date</u>
Annual periods beginning on or after 1 January 2018.

INCOME STATEMENT

For the year ended 31 December 2013

	Notes	**2013** **€m**	2012 €m
Interest and similar income	2	**275**	322
Interest expense and similar charges	2	**(137)**	(202)
Net interest income		**138**	120
Net trading expense	3	**(5)**	(10)
Other operating loss	4	**-**	(98)
Total operating income		**133**	12
Operating expenses	5	**(9)**	(8)
Operating profit before provisions		**124**	4
Provision for impairment losses of loans and advances to customers	8	**(129)**	(94)
Operating (loss) before taxation		**(5)**	(90)
Taxation on ordinary activities	6	**1**	12
(Loss) for the financial year		**(4)**	(78)

The operating loss is derived from continuing operations.

STATEMENT OF COMPREHENSIVE INCOME

For the year ended 31 December 2013

	2013 **€m**	2012 €m
(Loss) for the financial year	**(4)**	(78)
Other comprehensive income	**-**	-
Total comprehensive (loss) for the year	**(4)**	(78)

The notes on pages 82 to 102 are an integral part of these financial statements.

Director:

Director:

Date: 12 / 3 / 2014

Director:

Secretary:

STATEMENT OF FINANCIAL POSITION

As at 31 December 2013

	Notes	**2013 €m**	2012 €m
Assets			
Derivative financial instruments	15	**33**	35
Loans and advances to credit institutions	7	**89**	128
Loans and advances to customers	8	**5,983**	6,427
Deferred taxation	10	**23**	22
Intangible assets	9	**2**	2
Total assets		**6,130**	6,614
Liabilities			
Deposits by credit institutions	11	**2,978**	3,254
Derivative financial instruments	15	**33**	36
Accruals and deferred income	13	**-**	2
Other liabilities	14	**1**	-
Debt securities in issue	12	**2,694**	2,969
Total liabilities		**5,706**	6,261
Shareholders' equity			
Ordinary share capital	19	**552**	477
General reserves		**(128)**	(124)
Total shareholders' equity		**424**	353
Total liabilities and shareholders' equity		**6,130**	6,614

The notes on pages 82 to 102 are an integral part of these financial statements.

Director:　　　　　　Director:

Director:　　　　　　Secretary:

Date: 12 / 3/ 2014

STATEMENT OF CHANGES IN EQUITY *As at 31 December 2013*	**Ordinary share capital**	**General reserves**	**Total**
	€m	**€m**	**€m**
2013			
At beginning of year	**477**	**(124)**	**353**
Ordinary share capital issued	**75**	**-**	**75**
Total comprehensive (loss) for the year	**-**	**(4)**	**(4)**
At end of year	**552**	**(128)**	**424**
2012			
At beginning of year	477	(46)	431
Total comprehensive (loss) for the year	-	(78)	(78)
At end of year	477	(124)	(353)

STATEMENT OF CASHFLOWS

For the year ended 31 December 2013

	Note	2013 €m	2012 €m
Cash flows from operating activities			
Operating (loss) before taxation		**(5)**	(90)
Adjustments for:			
Amortisation of premium/discount on bonds in issue	2	**75**	82
Provision for impairment of loans and advances	8	**129**	94
Loss on disposals of loans	4	**-**	152
Gain on repurchase of debt securities in issue	4	**-**	(54)
Fair value movement on hedging derivatives		**(1)**	(1)
Fair value movement on hedged item		**-**	4
Operating income before changes in working capital and provisions		**198**	187
Net decrease in loans and advances to customers	8	**315**	503
Net increase in prepayments and accrued income		**-**	1
(Decrease)/increase in other liabilities		**1**	(2)
(Decrease) in deposits by credit institutions	11	**(276)**	(360)
(Increase) in accrual and deferred income	13	**(2)**	(4)
Cash used in operations		**236**	325
Income taxes refunded		**-**	-
Net cash used in operating activities		**236**	325
Net cash outflow from investing activities			
Cash flows from financing activities			
Issue of debt securities	12	**225**	985
Redemption of debt securities	12	**(575)**	(1,312)
Issue of share capital	19	**75**	-
Net cash outflow from financing activities		**(275)**	(327)
Net decrease in cash and cash equivalents		**(39)**	(2)
Cash and cash equivalents at beginning of period		**128**	130
Cash and cash equivalents at 31 December	7	**89**	128

NOTES TO THE FINANCIAL STATEMENTS

1. 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.

2. NET INTEREST INCOME

	2013	2012
	€m	€m
Interest income and similar income		
Loans and advances to customers	**251**	285
Amortisation of fair value discount on loans and advances to customers	**24**	37
Total interest income	**275**	322
Interest expense and similar charges		
Deposits by credit institutions	**(26)**	(44)
Debt securities in issue	**(36)**	(76)
Amortisation of fair value discount on debt securities in issue	**(75)**	(82)
Total interest expense	**(137)**	(202)
Net interest income	**138**	120

Included within various captions under interest income for the year ended 31 December 2013 is a total of €38m (2012: €33m) accrued on impaired financial assets.

3. NET TRADING EXPENSE

	2013	2012
	€m	€m
Interest rate derivative contracts	**(5)**	(10)

The net trading loss reflects the movement in the mark to market valuation and interest income and expense relating to asset swap hedging instruments.

Details on derivative financial instruments are also disclosed in note 15.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

4. OTHER OPERATING LOSS	**2013**	2012
	€m	€m
Gain on repurchase of debt securities in issue	**-**	54
Loss on the disposal of Loans and advances to customers	**-**	(152)
	-	(98)

Gain on repurchase of debt securities in issue
During 2012 the following debt securities in issue were bought back by EBS Mortgage Finance.

	2012	2012	2012	2012
	April	August	September	Total
	€m	€m	€m	€m
Nominal	150	150	150	450
Gain	1	29	24	54

Loss on the disposal of Loans and advances to customers

There were no loans disposed of in 2013.

On 1 October 2012 the Bank transferred Loans and advances to customers with a carrying value of €374m to its parent EBS Limited, resulting in a loss on disposal of €152m. The loans and advances to customers were derecognised from the Bank's financial statements. This transaction was on an arm's length basis. The portfolio of loans was immediately sold outside the Group for the same consideration.

5. OPERATING EXPENSES	**2013**	2012
	€m	€m
Service Fee payable to EBS	**6**	7
Other expenses	**3**	1
	9	8

Operating expenses includes service fee expense of €6m (2012: €7m) 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.

Other expenses include professional fees of €1.2m (2012: €1.0m) and statutory fee of €1.0m (2012: €0.2m).

Retirement benefits of €10k (2012: €15K) are included in other expenses.

Directors' remuneration in 2013 is €30k (2012: €30k). The full amount of Directors fees is in respect of services as a Director.

No additional remuneration has been made to any individuals employed directly by AIB p.l.c. for roles discharged as directors of EBS Mortgage Finance.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

5. OPERATING EXPENSES *(continued)*

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

	2013	2012
	€000	€000
Fees and expenses paid to our statutory auditors are analysed as follows:		
Audit of the individual financial statements	12	12
Tax advisory services	-	-
Other assurance services	-	-
Other non-audit services	-	-
	12	**12**

Auditor's remuneration of €12k (2012: €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 persons employed full time by the Bank, excluding its board in the reporting period was 1.8 (2012: 1.6). All employees are permanent staff members.

6. TAXATION

	2013	2012
	€m	€m
Current Taxation		
Corporation tax charge	-	-
Deferred Taxation		
Deferred tax credit	(1)	(12)
	(1)	(12)

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:

	2013	2012
	€m	€m
(Loss) before tax @ 12.5%	**(1)**	(12)
Effects of:		
Addbacks and income not taxable at standard rates	-	-
Other temporary differences	-	-
Under/(Over) provision in prior years	-	-
Total income tax expense/credit	**(1)**	(12)

There was no purchase of group relief from EBS or other subsidiaries of the Group (2012: Nil).

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

7. LOANS AND ADVANCES TO CREDIT INSTITUTIONS

	2013 €m	2012 €m
Funds placed with other banks outside AIB Group	**80**	70
Funds placed with EBS Limited	**9**	58
	89	128
Remaining Maturity: Three months or less	**89**	128
	89	128

For the purpose of cash flows the cash and cash equivalents comprise the above.

Loans and advances to credit institutions include balances with original maturities of less than 3 months.

The balances held with other Banks outside AIB Group represent the Cash Substitution Pool Assets.

Loans and advances to Credit Institutions by geographical area

Republic of Ireland	89	128

8. LOANS AND ADVANCES TO CUSTOMERS

	2013 €m	2012 €m
Repayable within one year	**1,255**	1,067
Repayable in more than one but less than five years	**94**	93
Repayable in more than five years	**5,015**	5,511
Total customer loans	**6,364**	6,671
Less provision for loan impairments	**(381)**	(244)
Total loans and advances to customers after provisions	**5,983**	6,427

Loans and advances to customers – Analysis by sector

	2013 €m	2012 €m
Home loans	**6,345**	6,655
Retail Buy to let loans	**19**	16
Total loans and advances to customers before provisions	**6,364**	6,671
Less provision for loan impairments	**(381)**	(244)
Total loans and advances to customers after provisions	**5,983**	6,427

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

8. LOANS AND ADVANCES TO CUSTOMERS *(continued)*

Fair value of the collateral held for residential mortgages is €5,562m at 31 December 2013 (2012: €5,687m) based on the CSO House Price Index.

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

By geographic location and sector

Republic of Ireland	**2013** **€ m**	2012 € m
Residential mortgages (net of provision)	**5,983**	6,427

PROVISION FOR LOAN IMPAIRMENTS	**2013** **€m**	2012 €m
Individual provision for loan impairments		
At beginning of the period	**200**	165
Charge of impairment loss	**135**	57
Impairment provisions utilised	**-**	(22)
At end of period	**335**	200
Collective provision for loan impairments		
At beginning of the period	**44**	6
Charge of impairment loss	**2**	43
Impairment provisions utilised	**-**	(5)
At end of period	**46**	44
Total provision for loan impairments (including unearned income provision)	**381**	244

The impairment charge recognised in the Income Statement of €129m (2012: €94m) is net of an amount received from EBS of €8m (2012: €6m) 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.

By geographic location and industry sector

Republic of Ireland	**2013** **€ m**	2012 € m
Residential mortgages	**381**	244

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

9. INTANGIBLE ASSETS

	2013	2012
	€m	€m
Computer Software		
At 1 January	**3**	3
At 31 December	**3**	3
Amortisation		
At 1 January	**1**	1
At 31 December	**1**	1
Net book amounts at 31 December	**2**	2

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 2013.

10. DEFERRED TAXATION

	2013	2012
	€m	€m
At 1 January	**22**	10
Current tax losses	**1**	12
At 31 December	**23**	22

At 31 December 2013 recognised deferred tax assets on tax losses and other temporary differences totalled €23m (2012: €22m). The tax losses arise in the Irish tax jurisdiction and their utilisation is dependent on the generation of future taxable profits.

The Bank believes that it is more likely than not that it will return to profitability by 2014 and will generate profits in the long term. In the absence of any expiry date for tax losses in Ireland, the Bank therefore believes that it is more likely than not that there will be future profits against which to use the tax losses. The Bank has carried out an exercise to determine the likely number of years required to utilise the deferred tax, which indicates the deferred tax asset will be fully utilised within 4 years.

11. DEPOSITS BY CREDIT INSTITUTIONS

	2013	2012
	€m	€m
Deposits by credit institutions – Analysis by contractual maturity		
Repayable in less than three months	**2,978**	3,254

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

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

11. DEPOSITS BY CREDIT INSTITUTIONS *(continued)*

The facility limit with EBS is €6bn and the balance at 31 December 2013 amounted to €3.0bn (2012: €3.3bn). 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.

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

	2013	2012
	€m	€m
Mortgage covered securities in issue:		
Opening balance	**2,969**	3,268
Issued during the year	**225**	985
Redemptions and repayments	**(575)**	(1,312)
Gain on repurchase of debt securities in issue	**-**	(54)
Amortisation of premium / discount	**75**	82
Closing balance at 31 December	**2,694**	2,969
Mortgage covered securities in issue by remaining maturity:		
Repayable in less than one year	**525**	497
Repayable in more than one year but less than five years	**2,169**	2,472
	2,694	2,969

	2013	2012
	€m	€m
Mortgage covered securities in issue -		
External and internal issuances at nominal value:		
External investors	**50**	50
EBS Limited	**2,750**	3,100
Nominal value of mortgage covered securities in issue	**2,800**	3,150
Debt securities in issue by geographical area		
Republic of Ireland	**2,694**	2,969

The carrying value of the debt securities in issue is €2,694m (2012: €2,969m), the Bank is contractually committed to paying the Nominal value €2,800m (2012: €3,150m) of the bonds on the redemption date for each individual bond, unless bonds are repurchased and cancelled prior to their contractual redemption date.

During 2012 debt securities in issue were bought back by EBS Mortgage Finance, see note 4 for further detail.

During the year ended 31 December 2013 the Bank issued one retained bond with a total nominal value of €225m and the bond was subscribed in full by EBS.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

12. DEBT SECURITIES IN ISSUE AND ASSET COVERED SECURITIES ACT INFORMATION *(continued)*

The retained bonds were recognised on the Statement of Financial Position at a value of €224.9m 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.

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.

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

		As at 31 December 2013		As at 31 December 2012	
From €	**To €**	**Total principal balances €m**	**Number of loans**	Total principal balances €m	Number of loans
Nil	100,000	**905**	**25,808**	972	27,948
100,000	200,000	**1,912**	**12,864**	2,021	13,568
200,000	500,000	**2,308**	**8,800**	2,598	9,829
Over 500,000		**158**	**226**	188	270
Total		**5,283**	**47,698**	5,779	51,615

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

	As at 31 December 2013		As at 31 December 2012	
	Number of mortgaged properties	**%**	Number of mortgaged properties	%
Geographical area:				
Dublin	**12,997**	**36**	14,084	36
Outside Dublin	**23,091**	**64**	24,712	64
Total	**36,088**	**100**	38,796	100

12(c) Non-performing mortgage loans in default in the cover assets pool

As at 31st December 2013 there were 1,065 (2012: 990) 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 1,065 (2012: 990) accounts was €4,426,902 (2012: €3,559,857).

12(d) Non-performing mortgage loans in the cover assets pool with arrears greater than €1,000

During the year ended 31 December 2013, 2,020 (2012: 2,627) mortgage loans in the cover assets pool were non performing with arrears greater than €1,000. As at 31 December 2013 2,169 (2012:834) mortgage loans were non-performing with arrears greater than €1,000 in the cover assets pool.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

12. DEBT SECURITIES IN ISSUE AND ASSET COVERED SECURITIES ACT INFORMATION *(continued)*

12(e) Replacement of non-performing mortgage loan accounts from the cover assets pool
During the year ended 31 December 2013, 1,095 (2012: 1,479) non performing 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.

12(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 2013 was €4,958,285 (2012: €4,740,845). None of the accounts in question were written off as at 31 December 2013.

12(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 year ended 31 December 2013 was €517.3m (2012: €602.7m), of which €312.1m (2012: €252.5m) represented repayment of principal and €205.2m (€2012: €350.2m) represented payment of interest.

12(h) Number and amount of mortgage loans in the cover assets pool secured on commercial property
As at 31 December 2013 and 2012 there were no loan accounts in the Cover Asset Pool that were secured on commercial properties.

13. ACCRUALS AND DEFERRED INCOME	**2013**	2012
	€m	€m
Interest payable on mortgage covered securities	**-**	1
Other accruals	**-**	1
At 31 December	**-**	2

14. OTHER LIABILITIES	**2013**	2012
	€m	€m
Sundry Creditors	**1**	-
At 31 December	**1**	-

15. DERIVATIVE FINANCIAL INSTRUMENTS

The Bank 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 (including resetting mortgage asset swap margins by agreement of both couterparties) of assets and liabilities in a cost efficient manner. This flexibility helps the Bank to achieve liquidity and risk management objectives.

To achieve its risk management objectives, the Bank uses interest rate swaps to hedge interest rate risk on mortgage loan accounts both within the Cover Assets Pool and outside the Cover Assets Pool, effectively converting interest receivable from a fixed rate basis to a floating rate basis.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

15. DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Although these swaps are considered to be an effective hedge in economic terms, due to their nature, it is not possible to establish a "fair value" hedging relationship under IAS 39 with the mortgage loan accounts and consequently, they 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. When used appropriately derivatives are an efficient and cost effective means of managing market risk and limiting counterparty exposure. The net fair value of these swaps at 31 December 2013 was nil (2012: (€1m)).

			2013			2012
	Notional principal amount	**Assets**	**Liabilities**	Notional principal amount	Assets	Liabilities
	€m	**€m**	**€m**	€m	€m	€m
Derivatives held for trading						
Interest rate swaps	**6,622**	**33**	**33**	6,963	35	36
Total trading contracts	**6,622**	**33**	**33**	6,963	35	36
Total derivative financial instruments	**6,622**	**33**	**33**	6,963	35	36

Derivative assets of €33m (2012: €35m) and derivative liabilities of €33m (2012: €36m) represent fair value of the derivative and related accrued interest. 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.

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

Derivative Maturity Table – at 31 December 2013

	Not more than 12 months €m	**Over 1 year but not more than 5 years €m**	**Over 5 years €m**	**Total €m**
Interest Rate Swaps	**-**	**4,838**	**1,784**	**6,622**
Total	**-**	**4,838**	**1,784**	**6,622**

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

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

15. DERIVATIVE FINANCIAL INSTRUMENTS *(continued)*

Derivative Maturity Table – at 31 December 2012

	Not more than 12 months €m	Over 1 year but not more than 5 years €m	Over 5 years €m	Total €m
Interest Rate Swaps	-	5,657	1,306	6,963
Total	-	5,657	1,306	6,963

The derivative maturity table below represents the positive fair value of interest rate swaps on asset derivatives based on yield curves as at 31 December 2013:

Positive fair value of interest rate swaps table – at 31 December 2013

	Not more than 12 months €m	**Over 1 year but not more than 5 years €m**	**Over 5 years €m**	**Total €m**
Interest Rate Swaps	**-**	**16**	**17**	**33**
Total Assets	**-**	**16**	**17**	**33**

Positive fair value of interest rate swaps table – at 31 December 2012

	Not more than 12 months €m	Over 1 year but not more than 5 years €m	**Over 5 years** €m	**Total** €m
Interest Rate Swaps	-	22	13	35
Total Assets	-	22	13	35

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

16. 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 2013. 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 at all times. The Bank's regulatory capital position at 31 December was as follows:

	2013	2012
	€m	€m
Tier 1 capital		
Ordinary Share Capital	**552**	477
Profit and loss account	**(128)**	(124)
Intangible assets	**(2)**	(2)
Total	**422**	351
Tier 2 capital		
Collective allowances for impairment	**40**	44
Total regulatory capital	**462**	395

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

17. 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 Allied Irish Banks, 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 of Allied Irish Banks, p.l.c. 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 Allied Irish Banks, p.l.c. As a result of these capital injections, the Irish Government, through the National Pension Reserve Fund Commission, now holds 99.8% of the ordinary shares of Allied Irish Banks, 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 Allied Irish Banks, 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 and payment of dividends;
- Restrictions on various types of remuneration;
- Buy-backs or redemption by the Group of its shares;
- The manner in which the Group extends credit to certain customer groups; and
- Conditions regulating the commercial conduct of Allied Irish Banks, p.l.c, having regard to capital ratios, market share and the Group's balance sheet growth.

(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.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

17. RELATED PARTY TRANSACTIONS *(continued)*

(c) Credit Institutions (Stabilisation) Act 2010
The Credit Institutions (Stabilisation) Act 2010 was passed into Irish law on 21 December 2010. The Act provides the legislative basis for the reorganisation and restructuring of the Irish banking system agreed in the joint EU/IMF Programme for Ireland ('the Programme'). This will allow the Minister for Finance ("the Minister") to take the actions required to bring about a domestic retail banking system that is proportionate to and focused on the Irish economy.

The Act provides broad powers to the Minister (in consultation with the Governor of the Central Bank of Ireland) to act on financial stability grounds to effect the restructuring actions and recapitalisation measures envisaged in the Programme. The Act applies to banks which have received financial support from the State, building societies and credit unions. Given the exceptional nature of the powers contained in the Act, the powers are time-limited and were scheduled to expire on 31 December 2012. However, in January 2013, the Minister extended the period of effectiveness of the Act for a further period of two years until 31 December 2014.

The powers provided in the Act allow the Minister to implement key aspects of the agreed Programme for bank restructuring and include the issue of direction orders, special management orders, subordinated liabilities orders and transfer of assets and liabilities orders. In addition, the Act gives the Minister broad powers in relation to directors and officers and their appointment/removal/duties. Various other terms are also imposed on relevant financial institutions as a condition for financial support.

(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 gave 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 2014 or at a later date substituted by resolution of both Houses of the Oireachtas.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

17. RELATED PARTY TRANSACTIONS *(continued)*

(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) Related Party Transaction with EBS Ltd

The following amounts represent the transactions and outstanding balances with the EBS:

- Loans from EBS at 31 December 2013 are €2,978m (2012: €3,254m).
- Deposits placed with EBS at 31 December 2013 are €9m (2012: €58m).
- The nominal value of debt securities in issue to EBS at 31 December 2013 are €2,750m (2012: €3,100m).

Derivative financial instruments with EBS Limited

Interest rate swaps	**2013**	2012
	€m	€m
Notional Principal amount	**6,622**	6,913
Assets (Fair value)	**33**	35
Liabilities (Fair value)	**33**	35

At 31 December 2013 there were no transactions between the Bank and the ultimate Parent, Allied Irish Banks, p.l.c.

	2013	2012
	€m	€m
Income and expense included in the Income Statement from related parties:		
Service fee	**(6)**	(7)
Interest expense on loans	**(26)**	(44)
Interest income from deposits	**-**	-
Gain on repurchase of debt securities in issue (see note 4)	**-**	54
Interest expense on debt securities	**(110)**	(122)
Net trading expense	**(5)**	(10)

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.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

17. RELATED PARTY TRANSACTIONS *(continued)*

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. There were no outstanding loans with key management personnel during 2013 (2012: €0.2).

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 (2012: nil).

18. FAIR VALUE OF FINANCIAL INSTRUMENTS

The term ‘financial instruments’ includes both financial assets and financial liabilities. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The Banks’ accounting policy for the determination of fair value of financial instruments is set out in accounting policy number 1.8.

Readers of these financial statements are advised to use caution when using the data in the following table to evaluate the Bank’s financial position or to make comparisons with other institutions. Fair value information is not provided for items that do not meet the definition of a financial instrument. These items include intangible assets such as the value of the branch network and the long-term relationships with depositors, premises and equipment and shareholders’ equity. These items are material and accordingly, the fair value information presented does not purport to represent, nor should it be construed to represent, the underlying value of the Bank as a going concern at 31 December 2013.

The valuation of financial instruments, including loans and receivables, involves the application of judgement and estimation. Market and credit risks are key assumptions in the estimation of the fair value of loans and receivables. During the year, the Bank has continued to observe adverse changes in the credit quality of its borrowers, with increasing delinquencies and defaults across a range of sectors. The volatility in financial markets and the illiquidity that is evident in these markets has reduced the demand for many financial instruments and this creates a difficulty in estimating the fair value for loans to customers. The Bank has estimated the fair value of its loans to customers taking into account market risk and the changes in credit quality of its borrowers.

Fair values are based on observable market prices where available, and on valuation models or techniques where the lack of market liquidity means that observable prices are unavailable. The fair values of financial instruments are measured according to the following fair value hierarchy:
Level 1 – financial assets and liabilities measured using quoted market prices from an active market (unadjusted).
Level 2 – financial assets and liabilities measured using valuation techniques which use quoted market prices from an active market or
measured using quoted market prices unadjusted from an inactive market.
Level 3 – financial assets and liabilities measured using valuation techniques which use unobservable market data.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

18. FAIR VALUE OF FINANCIAL INSTRUMENTS *(continued)*

All financial instruments are initially recognised at fair value. Financial instruments held for trading and financial instruments in fair value hedge relationships are subsequently measured at fair value through profit or loss. Available for sale securities and cash flow hedge derivatives are subsequently measured at fair value through other comprehensive income.

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

Financial instruments measured at fair value in the financial statements

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

Counterparty credit is an input into the valuation of uncollateralised customer derivatives. Own credit is also an input into the valuation of uncollateralised customer derivatives.

Financial instruments not measured at fair value but with fair value information presented separately in the notes to the financial statements
Loans and receivables to credit institutions
The fair value of loans and receivables to credit institutions is estimated using discounted cash flows applying either market rates, where practicable, or rates currently offered by other financial institutions for placings with similar characteristics.

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

In addition to the assumptions set out above under valuation techniques regarding cash flows and discount rates, a key assumption for loans and receivables is that the carrying amount of variable rate loans (excluding mortgage products) approximates to market value where there is no significant credit risk of the borrower. The fair value of variable rate mortgage products including tracker mortgages is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in the portfolio. For fixed rate loans, the fair value is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in that portfolio.

For the overall loan portfolio, an adjustment is made for credit risk which at 31 December 2013 took account of the Banks' expectations on credit losses over the life of the loans.

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

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

18. FAIR VALUE OF FINANCIAL INSTRUMENTS *(continued)*

Debt securities in issue

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

Fair Value of Financial Instruments

The following table sets out the carrying amount and fair value of financial instruments across the three levels of the fair value hierachy at 31 December 2013:

	Carrying amount in statement of financial position						Fair Value hierarchy			
	At fair value through profit and loss		At fair value through equity	At amortised cost		Total				
	Held for trading	Fair value hedge derivatives	Cashflow hedge derivatives	Loans and receivables	Other		Level 1	Level 2	Level 3	Total
Financial assets measured at fair value	**€m**	**€m**	**€m**	**€m**	**€m**	**€m**				
Derivative financial instruments										
Interest Rate Derivatives	**33**	**-**	**-**	**-**	**-**	**33**	**-**	**33**	**-**	**33**
Financial assets not measured at fair value										
Loans and receivables to credit insitutions	**-**	**-**	**-**	**89**	**-**	**89**	**89**	**-**	**-**	**89**
Loans and receivables to customers	**-**	**-**	**-**	**5,983**	**-**	**5,983**	**-**	**-**	**5,683**	**5,683**
	33	**-**	**-**	**6,072**	**-**	**6,105**	**89**	**33**	**5,683**	**5,805**
Financial liabilities measured at fair value										
Derivative financial instruments										
Interest Rate Derivatives	**33**	**-**	**-**	**-**	**-**	**33**	**-**	**33**	**-**	**33**
Financial liabilities not measured at fair value										
Deposits by credit institutions	**-**	**-**	**-**	**-**	**2,978**	**2,978**	**-**	**-**	**3,127**	**3,127**
Debt securities in issue	**-**	**-**	**-**	**-**	**2,694**	**2,694**	**2,510**	**-**	**-**	**2,510**
	33	**-**	**-**	**-**	**5,672**	**5,705**	**2,510**	**33**	**3,127**	**5,670**

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

Fair Value of Financial Instruments

The following table sets out the carrying amount and fair value of financial instruments across the three levels of the fair value hierachy at 31 December 2012:

	Carrying amount in statement of financial position					
	At fair value through profit and loss		At fair value through equity	At amortised cost		Total
	Held for trading	Fair value hedge derivatives	Cashflow hedge derivatives	Loans and receivables	Other	
Financial assets measured at fair value	€m	€m	€m	€m	€m	€m
Derivative financial instruments						
Interest Rate Derivatives	35	-	-	-	-	35
Financial assets not measured at fair value						
Loans and receivables to credit insitutions	-	-	-	128	-	128
Loans and receivables to customers	-	-	-	6,427	-	6,427
	35	-	-	6,555	-	6,590
Financial liabilities measured at fair value						
Derivative financial instruments						
Interest Rate Derivatives	36	-	-	-	-	36
Financial liabilities not measured at fair value						
Deposits by credit institutions	-	-	-	-	3,254	3,254
Debt securities in issue	-	-	-	-	2,969	2,969
	36	-	-	-	6,223	6,259

All financial derivatives are considered Level 2 hierarchy in 2012.

NOTES TO THE FINANCIAL STATEMENTS *(continued)*

19. SHARE CAPITAL

	2013 €m	2012 €m
Authorised:		
1,000,000,000 ordinary shares of €1.00 each	**1,000**	1,000
Issued and fully paid:		
551,540,000 ordinary shares of €1.00 each (2012: 476,540,000 ordinary shares of €1.00 each)	**552**	477

On 20 December 2013, the Bank issued 75,000,000 €1 ordinary shares at par.

The shares were issued to ensure that the Bank continued to exceed its regulatory capital requirement.

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.

20. 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.

21. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on the 12th March 2014.