

# **EBS MORTGAGE FINANCE**

**DIRECTORS' REPORT AND ANNUAL FINANCIAL STATEMENTS**  
**For the financial year ended 31 December 2016**

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**DIRECTORS AND OTHER INFORMATION**

<b>DIRECTORS</b>	Denis Holland William Cunningham Gerry Gaffney Owen Purcell	Non-Executive Director and Chairman Independent Non-Executive Director Executive Director Executive Director (Managing Director)
<b>SECRETARY</b>	Catherine Kelly	
<b>REGISTERED OFFICE</b>	The EBS Building 2 Burlington Road Dublin 4 Ireland	
<b>REGISTERED NUMBER</b>	463791	
<b>REGISTERED AUDITOR</b>	Deloitte Chartered Accountants & Statutory Audit Firm Deloitte & Touche House Earlsfort Terrace Dublin 2	
<b>BANKERS</b>	EBS Designated Activity Company 2 Burlington Road Dublin 4 Ireland  BNP Paribas Ireland 5 George's Dock International Financial Services Centre Dublin 1 Ireland	
<b>COVER-ASSETS MONITOR</b>	Mazars Harcourt Centre Block 3 Harcourt Road Dublin 2 Ireland	

## DIRECTORS' REPORT

The Directors of EBS Mortgage Finance (hereafter referred to as "EBSMF" or the "Bank") present their Directors' Report ("the Report") and audited financial statements for the financial year ended 31 December 2016. A Statement of Directors' Responsibilities in relation to the financial statements appears on page 46.

### Principal activities

EBSMF, 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. EBSMF have been granted a derogation as permitted under section 1237(5) Companies Act 2014 by the Minister of Jobs, Enterprise and Innovation from the requirement to include 'unlimited company' in its name. The Bank is a wholly owned subsidiary of EBS Designated Activity Company ('EBS d.a.c.' or 'EBS' or 'Parent') and a member of EBS Group (the 'Group'). EBS is a wholly owned subsidiary of Allied Irish Banks, p.l.c. ('AIB p.l.c.' or 'AIB Group') and its debt securities are listed on the main securities market of the Irish Stock Exchange. AIB Group and its subsidiaries, including EBSMF, came under the direct supervision of, and are deemed to be authorised by the European Central Bank ('ECB') since the introduction on 4 November 2014 of the Single Supervisory Mechanism ('SSM'). The SSM places the ECB as the central prudential supervisor of financial institutions in the Eurozone, including AIB and its subsidiaries. The Bank continues to be supervised by the Central Bank of Ireland (the "CBI") for non-prudential matters, including, consumer protection and the combat of money laundering.

The Bank's principal objective is to issue mortgage covered securities for the purpose of financing mortgage loans secured on residential property in accordance with the Asset Covered Securities Act, 2001 and the Asset Covered Securities (Amendment) Act 2007 ('the Asset Covered Securities Acts'). 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 may subsequently transfer 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 that 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.

The business strategy for 2017 is anticipated to continue to entail the provision of liquidity to AIB p.l.c. 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, Asset Covered Securities Acts and rating agency requirements. The ongoing amortization of the cover pool, with all other things being equal, will result in declining nominal and regulatory over collateralisation ('OC') levels, however given the extent of the surplus OC available with respect to current bonds outstanding there will be no requirement to re-purchase and cancel outstanding bonds.

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

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

All of the Bank's operational & support activities are outsourced to AIB p.l.c. under a Managed Services Agreement. AIB, as Service Provider for the Bank, services the mortgage loans, and provides treasury services in connection with financing as well as a range of other support services.

### Corporate Governance

#### *The Board of Directors*

The Board is responsible for corporate governance encompassing leadership, direction and control of the Bank and is responsible for financial performance to its shareholder and ultimate parent AIB p.l.c. Governance is exercised through a Board of Directors ('the Board') and a Senior Management Team. The conditions of the Bank's Central Bank licence require that there should be a minimum of two Non-Executive Directors who are independent of the parent company. Throughout 2016, there were two Non-Executive Directors on the Board of the Bank. The Board also includes two Executive Directors, both of whom are directly involved in the operation of the Bank. Group Non-Executive Director, Ms. Fidelma Clarke resigned from the Board with effect from 30 September 2016 and proposed action in relation to the appointment of a new Group Non-Executive Director is currently under consideration by the CBI.

**DIRECTORS' REPORT (continued)****Corporate Governance (continued)**

The Board is responsible for ensuring that appropriate systems of internal controls and risk management are maintained, specifically the Board sets the Risk Appetite Statement, approves the Risk Framework and approves the annual financial plans. The Bank benefits as a subsidiary of AIB from the wider AIB Group governance and operating structure, including in relation to oversight of audit and risk related activities. AIB and EBS provide services to EBSMF through an Outsourcing and Agency Agreement, a formal managed services agreement, updates in respect of the performance against which are provided to the Board regularly.

In the event that material failings or weaknesses in the systems of risk management or internal control are identified, an explanation of the issue and an assessment of its impact is presented with a proposed remediation plan to the Board. Agreed remediation plans are tracked to conclusion, with status updates provided to the Board. Given the work of the Board and representations made by the Management Team during the year, the Board is satisfied that the necessary actions to address any material failings or weaknesses identified through the operation of the risk management and internal control framework have been taken, or are currently being undertaken. Taking all other information into consideration as outlined above, the Board is satisfied that there has been an effective system of control in place throughout the year.

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

The Board also receives regular updates on the Bank's risk profile through a quarterly report from AIB's Risk function, and during 2016, considered the outcome of internal and external audit activities.

The Board held 4 scheduled meetings during 2016 and 1 out of course meeting was also held further detail about Directors' attendance of the meetings can be found in the table below.

EBSMF is subject to the CBI's Corporate Governance Requirements for Credit Institutions 2015 ("the 2015 Requirements") (which are available on [www.centralbank.ie](http://www.centralbank.ie)), which became effective for all credit institutions on 11 January 2016. Under the 2015 Requirements, the Bank is designated as a "high impact institution", which resulted in a number of significant incremental obligations. The Bank sought and received derogations from the CBI from a number of the significant incremental obligations including those relating to Board Committees, Board composition, and meeting frequency. Following the resignation of Ms. Clarke as noted above the Bank is not compliant with the 2015 Requirements as it is required to have 5 Directors on the Board. As noted previously, proposed action in relation to the appointment of a new Group Non-Executive Director is currently under consideration by the ECB.

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

**Establishment of an Audit Committee**

The Bank does not have an Audit Committee. A derogation was received, from the CBI, from the requirement to establish one.

The Board considers all audit matters including:

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

These responsibilities are discharged through its meetings with and receipt of reports from the Auditor and management including Finance, Internal Audit and Risk. At its meetings during 2016 the Board reviewed the annual financial statements, and related accounting policies, key judgements, and practices; the effectiveness of internal controls; and the findings, conclusions and recommendations of the Auditor and Group Internal Audit. The Board satisfied itself through regular reports from Group Internal Audit, Risk and the Auditor, and through reports on the performance of services from AIB and EBS under the Outsourcing and Agency Agreement, that the system of internal controls supporting EBSMF were effective. The Board is satisfied that appropriate measures are taken to consider and address any control issues identified by Group Internal Audit and the Auditor.

**Business review**

The Irish economy improved generally during 2016 including a decreasing unemployment rate standing at 7.2% at the end of December 2016 against 8.8% in 2015 (Source: Central Statistics Office) and decreasing mortgage arrears. Total market mortgage drawdowns in Ireland were €5.7bn (Source: Banking & Payments Federation of Ireland ('BPF')) in 2016 compared with €4.9bn in 2015, an increase of 16%.

The CSO Residential Property Price Index showed an increase in prices nationally of 8.1% in the 12 months to December 2016 (6.6% in 2015). This was particularly evident outside Dublin where the 2016 annual increase was 12.0% (December 2015 10.2%). Property prices in Dublin increased in the 12 month period by 5.7% (increase of 2.6% in 2015). The residential property price fall from peak (February 2007) was 33% Dublin and 37% non-Dublin at 31 December 2016 (2015: 35% Dublin and 36% non-Dublin).

**DIRECTORS' REPORT (continued)****Business review (continued)**

The Bank's loan portfolio before provisions decreased by 6.8% during 2016 to €5.2bn as at 31 December 2016 principally due to customer's repayments and loan restructuring (2015: decrease 6.9%).

EBS Mortgage Finance's residential mortgage portfolio comprises €5.2bn owner occupier (2015: €5.5bn) and €0.02bn buy-to-let mortgages (2015: €0.02bn). At 31 December 2016, EBS Mortgage Finance mortgage loans accounted for 14.8% (2015: 15.1%) of the AIB Group's residential mortgage portfolio of €35.2bn (2015: €36.8bn).

As a result of positive trends in the Irish economy, including an improving residential property market and decreasing unemployment, leading to an improvement in asset values and borrower repayment capacity, the Bank's impaired loans have decreased by 22% to €0.8bn, equal to 14.6% of total loans (2015: €1.0bn or 17.3%).

**Mortgage arrears resolution strategy**

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

At 31 December 2016, there were forbearance solutions in place on circa 8k accounts with loan balances of €1bn (2015: circa 9k accounts with €1.1bn balance). The stock of loans subject to forbearance decreased by €45m in 2016, due to the adoption of a definition of forbearance as prescribed by the European Banking Authority, and is mainly a reflection of the requirement to apply a probation period to loans subject to forbearance, which was not applied under the previous definition used.

**Results for the year**

EBS Mortgage Finance generated a profit before taxation for 2016 of €138m, compared to €122m in 2015. Increased profitability is due to lower funding costs and administration expense due to a transfer out of a restitution provision of €15m (2015: charge of €35m), offset by credit provision charge of €20m (2015: writeback of €10m). Profit after tax of €121m was added to Shareholders Equity in 2016 compared to €107m in 2015.

**Net Interest Margin/Income**

The net interest margin for 2016 was 3.30% an increase of 0.37% compared to 2.93% for 2015 due to reduced interest expense of €35m (2015: €69m), as a result of lower market interest rates and the early maturity of a higher interest rate bond, offset by lower interest income of €205m (2015: €231m) due to reductions in fixed and variable customer rates and lower average customer loan balances.

**Other operating expense**

Other operating expenses of €10m (2015: €9m) is due to the loss on an early maturity of a bond.

**Administration Expenses**

Administrative expenses decreased by €39m to €5m for 2016 (2015: €44m) due to the transfer out of a provision of €15m (2015: €35m charge) for customers redress and other related matters relating to a request from the Central Bank of Ireland ("CBI") in December 2015, to the Irish banking industry, including AIB, to conduct a broad examination of tracker mortgage related issues. This was offset by an €11m increase in service charge payable to EBS under the Loan Servicing Agreement following a benchmarking exercise.

**Provisions Write back\ Charge**

Overall provision charge for 2016 of €20 m compared to a write back €10m in 2015, a movement of €30m. Specific impairment provision charge has increased by €1m to €19m in 2016 (2015: €18m). The Incurred but Not Reported ("IBNR") stock levels have been increased in 2016, resulting in a charge of €1m (2015: €28m write back).

Specific provision stock amounts to €258m (2015: €253m) and IBNR provisions stand at €29m (2015: €28m) as at 31 December 2016. Total provisions as percentage of total loans covered increased to 5.6% (2015: 5.1%).

**Funding activities**

There was a favourable technical market backdrop for covered bonds in 2016, with the ECB's covered bond purchase programme (CBPP3) continuing to actively buy bonds in both the primary and secondary markets during the year. CBPP3 is aimed at enhancing the functioning of the monetary policy transmission mechanism, supporting financing conditions in the euro area, and facilitating credit provision to the real economy. As of March 30th, 2017 the holdings under CBPP3 amount to circa €214bn. The ECB left the main refinancing rate unchanged in 2016 but extended the term of the asset purchase programme by a further nine months to the end of 2017 or beyond if necessary, citing risks as "tilted to the downside".

Covered bond spreads tightened over the course of 2016, supported by CBPP3 buying and a reduction in net supply as issuers utilised other funding sources, such as the ECB's Targeted Long Term Refinancing Operation scheme (TLTROII).

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

At 31 December 2016, the total amount of principal outstanding in respect of mortgage covered securities issued was €1.5bn (31 December 2015: €2.40bn) subscribed for in full by EBS d.a.c.. The Bank repurchased the €425m Series 6 in February 2016 and the €225m Series 13 in May 2016. The Bank also repurchased both the €150m Series 9 and €300m Series 12 bonds in November 2016. In February 2016 the Bank increased the Series 11 bond by €200m to €500m. The Bank then repurchased this €500m in full in December 2016. The Bank issued the Series 16 covered bonds of €500m in June 2016. At the end of 2016, the total nominal value of covered bonds issued was €1.5bn subscribed for in full by EBS.

Moody's upgraded the EBS Mortgage Finance covered bond programme to Aaa from Aa1 in November 2016. Fitch upgraded the covered bond programme rating to AA from A+ also in November 2016.

The ratings as at 13 February 2017, for the Bank's Covered Bond Programme, AIB Group, and Ireland are shown below:

Rating Agency	EBS Mortgage Finance Covered Bond Programme	Allied Irish Banks, p.l.c. Issuer default rating	Ireland (Sovereign)
Fitch	AA	BB+	A
Moody's	Aaa	Ba3	A3

A decision to reduce the number of ratings on the Bank's bond programme from two ratings to one was taken by management in February 2017. The Bank's principal activity is to provide liquidity to AIB p.l.c. via the issue of suitably rated ECB repo eligible collateral. The ECB require one rating for eligibility purposes. The EBSMF decision to withdraw Fitch's ratings on the covered bond programmes is also in line with the Group and Bank cost and efficiency objectives. The EBSMF bond programme continues to be rated by Moodys at Aaa.

**Share capital**

The share capital of the Bank is €552m (2015: €552m), comprised of ordinary shares of €1 each.

**Capital resources and regulatory capital ratios**

The table below shows the components of the EBS Mortgage Finance's Common equity Tier 1 and total capital ratios as at 31 December 2016 and 31 December 2015.

	CRD IV Transitional basis	
	31 December 2016 €m	31 December 2015 €m
Core tier 1/common equity tier 1 capital	747	626
Total Tier 2 capital	17	20
Total capital	764	646
Risk Weighted Assets	2,419	2,760
Core tier 1/common equity tier 1 ratio	30.9%	22.7%
Total capital ratio	31.6%	23.4%

The Capital Requirements Directive IV ("CRD IV"), which came into force on 1 January 2014, comprises a Capital Requirements Directive and a Capital Requirements Regulation which implements the Basel III capital proposals together with transitional arrangements for some of its requirements. Under the fully loaded CRD IV capital basis the impact of the deduction of the deferred tax asset reduces the Total Capital ratio by 0.7%.

**Outlook**

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

**Risk Management**

The risk management framework provides a bank-wide definition of risk and lays down principles of how risk is to be identified, assessed, measured, monitored and controlled / mitigated, and the associated allocation of capital against same. Further information in relation to Risk Management, including principal risks and uncertainties facing EBSMF, as required under the terms of the European accounts Modernisation Directive (2003/51/EEC) (implemented in Ireland by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005) is set out in the Management Report on pages 9 to 45.

**DIRECTORS' REPORT (continued)****Going concern**

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

EBS Mortgage Finance is dependent on its ultimate parent, Allied Irish Banks, p.l.c. for continued funding and is therefore dependent on the going concern status of the ultimate parent.

The financial statements of Allied Irish Banks, p.l.c. have been prepared on a going concern basis. 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 2017 to 2019 approved by the Board in December 2016, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios. In formulating these plans, the current Irish economic environment and forecasts for growth and employment were considered as well as the stabilisation of property prices. The Directors of AIB Group have also considered the outlook for the Eurozone and UK economies, and the factors and uncertainties impacting their performance including the possible fallout from Brexit.

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

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

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

The Directors and Company Secretary did not hold any shares in the parent company Allied Irish Banks, p.l.c..

**Share options**

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

**Long term incentive plans**

There were no conditional grants of awards of ordinary shares outstanding to Executive Directors or the Company Secretary at 31 December 2016. Independent Non-Executive Directors do not participate in long term incentive plans.

**Attendance at scheduled Board Meetings**

	Scheduled Meetings		Out of course	
	A	B	A	B
<b>Directors</b>				
William Cunningham	4	3	1	1
Fidelma Clarke	3	3	1	1
Gerry Gaffney	4	4	1	1
Denis Holland	4	4	1	1
Owen Purcell	4	4	1	1

Column A indicates the number of scheduled meetings held during 2016 which the Director was eligible to attend; Column B indicates the number of meetings attended by each Director during 2016.

**Directors and Secretary during the year**

The following were Directors of EBSMF during 2016 – Fidelma Clarke, William Cunningham, Gerry Gaffney, Denis Holland and Owen Purcell. Ms Clarke resigned with effect from 30 September 2016.

The Company Secretary during 2016 was Catherine Kelly.

There were no changes in the Directors' and Secretary's interests between 31 December 2016 and 30 March 2017.

**Directors Remuneration**

Details of total remuneration of the Directors in office during 2016 and 2015 are shown in the Remuneration Table on page 71.



**DIRECTORS' REPORT (continued)****Dividend**

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

**Capital**

Information on the structure of the Bank's share capital, including rights and obligations attaching to each class of shares, is set out in note 18 of the consolidated financial statements.

**Adequate Accounting Records**

The Directors believe that they have complied with the requirements of Section 281 to 285 of the Companies Act 2014 with regard to adequate accounting records by allocating personnel with appropriate expertise and by providing adequate resources to the financial function under the Managed Services Agreement for the provision of various services including accounting and other financial services to EBSMF by AIB p.l.c.. The accounting records of the Company are maintained at the registered office of its ultimate parent at AIB, Bankcentre, Ballsbridge, Dublin 4.

**Political donations**

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

**Branches outside the State**

The Bank has not established any branches outside the State.

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

The Bank did not receive a Disclosure Notice under Section 33AK of the Central Bank Act 1942 during 2016.

**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.

**Statement of relevant audit information**

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

- a) so far as the Director is aware, there is no relevant audit information of which the Bank's Auditor is unaware; and
- b) the Director has taken all steps that he ought to have taken as a Director in order to make himself aware of any relevant audit information and to establish that the Bank's Auditor is aware of that information.

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

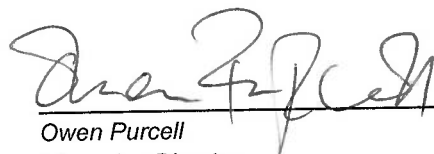
**Independent auditor**

Deloitte, Chartered Accountants and Statutory Audit Firm, has expressed their willingness to continue in office under Section 383(2) of the Companies Act 2014.

On behalf of the Board,



Denis Holland  
Chairman



Owen Purcell  
Managing Director

30 March 2017

## RISK MANAGEMENT REPORT

### 1. Introduction

EBSMF's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed on an AIB Group wide basis. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of the AIB Group's risk management framework. The principal risks and uncertainties facing AIB Group are discussed on pages 50 to 58 of the AIB Group's Annual Financial Report 2016.

### 2. Risk framework

EBSMF relies on the AIB Group framework and its supporting policies, processes and governance. AIB Group's risk governance and management framework is described on pages 59 to 61 of the AIB Group's Annual Financial Report 2016. For more information on the operation of the Board of EBS Mortgage Finance see page 3 to 4 of this Report.

### 3. Individual risk types

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

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

#### 3.1 Credit risk

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

Credit risk management objectives are to:

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

Maximum exposure to credit risk from on balance sheet and off balance sheet financial instruments is presented before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements).

For financial assets recognised on the statement of financial position, the maximum exposure to credit risk equals their carrying amount, and for loan commitments that are irrevocable over the life of the respective facilities, it is the full loan amount of the committed facilities.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Maximum exposure to credit risk\***

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

	2016			2015		
	Amortised Cost € m	Fair Value € m	Total € m	Amortised Cost € m	Fair Value € m	Total € m
Derivative financial instruments	-	19	19	-	20	20
Loans and receivables to banks	49	-	49	60	-	60
Loans and receivables to customers	4,880	-	4,880	5,265	-	5,265
Included elsewhere:						
Accrued interest	-	-	-	-	-	-
Other assets	-	-	-	-	-	-
	4,929	19	4,948	5,325	20	5,345
Off balance sheet loan commitments	10	-	10	11	-	11
Maximum exposure to credit risk	4,939	19	4,958	5,336	20	5,356

**Credit risk organisation and structure**

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

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

**Measurement of credit risk**

One of the objectives of credit risk management is to accurately quantify the level of credit risk to which AIB 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;
- Loss given default ("LGD") – the loss associated with a defaulted loan or borrower, and;
- Expected loss ("EL") – the loss that can be incurred as a result of lending to a borrower that may default. It is the average expected loss in value over a specified period.

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

Models generally use a combination of statistical analysis (using both financial and non-financial inputs) and expert judgement. For the purposes of calculating credit risk, each probability of default model segments counterparties into a number of rating grades, each representing a defined range of default probabilities. Exposures migrate between rating grades if the assessment of the counterparty probability of default changes. These individual rating models continue to be refined and recalibrated based on experience.

Mortgage applications are assessed centrally with particular reference to affordability, assisted by scoring models. However, for larger cases with connected exposures, some mortgage applications are assessed by the relevant credit authority. Both application scoring for new customers and behavioural scoring for existing customers are used to assess and measure risk as well as to facilitate the management of the portfolio.

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

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Measurement of credit risk (continued)**

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 EBS, criticised loans include 'watch', 'vulnerable' and 'impaired' loans which are defined as follows:

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

The Bank's criticised portfolio, which noted above includes impaired loans, is subject to a more intense assessment and review because of the increased risk associated with them. Credit management and credit risk management continues to be a key area of focus. Resourcing, structures, policy and processes are subjected to on-going review in order to ensure that the Bank is best placed to manage asset quality and assist borrowers in line with agreed treatment strategies.

**Risk management and mitigation**

Credit risk management in EBSMF is supported by an appropriate governance structure at AIB Group level with separation of function between the sourcing and approval of business, the issuing of funds, loan management and independent review and monitoring.

The AIB Group Executive Risk Committee ("ERC") is responsible for reviewing appropriate credit risk management structures, forbearance strategies and policies in line with the credit risk appetite of AIB Group and for monitoring the performance of the book.

All customer requests for credit are subject to a credit assessment process, which is exercised by an independent credit function.

Depending on the size and nature of the credit, the assessment process is assisted by standard application formats in order to assist the credit decision maker in making an informed credit decision. The credit approval authority is dependent on the size of the credit application.

The AIB Risk Analytics team is responsible for the development and on-going 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 loan assets.

The AIB Credit Review team assesses the application of credit policies, processes and procedures across all areas of AIB Group, including EBSMF.

EBSMF rely on AIB Group to conduct 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, AIB Group conducts a quarterly assessment of impairment provisions, assisted by the Risk Analytics and Credit divisions and evaluated by the AIB Group Credit Committee ("GCC").

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Collateral**

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

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

Collateral valuations are required at the time of origination of each residential mortgage. The Bank adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of collateral. When assessing the value of residential properties, recent transactional analysis of comparable sales in the area combined with the Central Statistics Office ("CSO") Residential Property Price index in the Republic of Ireland are used.

**Forbearance strategies\***

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

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

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

AIB 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 AIB Group's Mortgage Arrears Resolution Process ("MARP").

The strategy is built on three key factors:

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

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

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

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

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

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

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

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

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

***Loan loss provisioning***

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

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

It is EBSMF's policy to provide for impairment promptly and consistently across the loan book. All business areas formally review and confirm the appropriateness of their provisioning methodologies and the adequacy of their impairment provisions on a quarterly basis. Forborne loans are tested for impairment on a portfolio basis and all EBSMF loans are automatically impaired when the account reaches 90 days past due.

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

**Mortgage portfolio triggers**

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

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

- Loss of significant tenant/material reduction in rental income;
- Significant financial difficulty;
- Decrease in cash flow;
- Loss of employment;
- Net worth; and
- Planned sale of property asset did not take place.
- Disappearance of an active market for refinancing or sale of assets.

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

- the bank's aggregate exposure to the customer;
- the amount and timing of expected receipts and recoveries;
- the realisable value of security (or other credit mitigants) and likelihood of successful repossession;
- the likely deduction of any costs involved in recovery of amounts outstanding; and
- the ability of the borrower to obtain and make payments in the currency of the loan if not denominated in local currency.

***Specific provisions***

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

When raising specific impairment provisions, the Bank divides its impaired portfolio into two categories, namely Individually Significant (IS) and Individually Insignificant (II).

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

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

Across the Group portfolios, the Individually Significant threshold is €1,000,000 by customer connection. The calculation of an impairment charge for loans below the 'Significant' threshold is undertaken on a collective basis.

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

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

Within EBS, principal dwelling home ("PDH") loans greater than €1,000,000 are assessed and provided for through an automated process as opposed to individual assessments. The process takes into consideration collateral values and any costs in obtaining and selling associated collateral.

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

Provisioning is assessed on a collective basis to estimate losses for homogeneous groups of loans that are considered individually insignificant. This applies for customer connections less than €1,000,000.

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

Individually insignificant mortgage specific provisions are calculated using a collective mortgage provisioning model. This methodology is based on the calculation of three possible resolution outcomes: cure; forbearance (with and without loss); and repossession (forced and voluntary), with different loss rates associated with each. 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 have been refined during the year based on an additional one year dataset.

Key model parameters at 31 December 2016 for owner occupier mortgages are as follows: cure (14%) and disposal / forbearance (86%) (2015: cure 6% and disposal / advanced forbearance 94%).

The corresponding buy-to-let model parameters are as follows: cure (7%); disposal / forbearance (93%) (2015: cure 3.5% and disposal/advanced forbearance 96.5%).

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

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

The model parameters are reviewed at Group credit committee on a quarterly basis. The main parameter changes for the year ended 31 December were increases in the probabilities of disposal and cure, changes in the CSO index and in the property market fall from peak, increases in disposal haircuts and recovery periods.

***Incurred But Not Reported Provisions (IBNR)\****

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

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

*Loan loss provisioning (continued)**Incurred But Not Reported Provisions (IBNR)\* (continued)*

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

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

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

The table below sets out the parameters used in the calculation of IBNR provisions for the residential mortgages portfolio:

2016

Grade	Owner-Occupier			Buy-to-let		
	Exposure €m	Average PD %	Average LGD %	Exposure €m	Average PD & LGD %	Average LGD %
Good upper <sup>(1)</sup>	3,325	0.6	14.6	6	2.0	21.7
Good lower <sup>(2)</sup>	631	3.2	19.0	4	3.4	40.7
Watch	403	15.5	17.6	-	95.8	33.9
Vulnerable	46	55.9	20.3	-	75.7	27.1

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

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

The parameters for Cured and Forborne – Not impaired, are set out below. As a result, these sub portfolios within the residential mortgages carry a higher level of IBNR. It should be noted that due to the small volumes of Buy-To-Let exposures in these categories the average PDs and LGDs can vary significantly – this is the main driver of the change in these values:

Cured	225	12.3	20.0	1	68.0	31.4
Forborne – Not impaired	787	8.0	17.7	1	14.0	25.0

2015

Grade	Owner-Occupier			Buy-to-let		
	Exposure €m	Average PD %	Average LGD %	Exposure €m	Average PD %	Average LGD %
Good upper	2,529	0.6	16.4	2	1.7	9.8
Good lower	1,546	2.7	21.2	7	5.7	32.3
Watch	431	15.9	19.6	-	96.0	29.5
Vulnerable	66	57.6	20.9	-	-	-

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

Cured	326	15.3	20.5	1	18.2	18.2
Forborne – Not impaired	525	100	23.4	1	100	27.6

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 IBNR mortgage models. The mortgage provision model calculates individually insignificant specific provisions and IBNR provisions. Any additional IBNR, where appropriate, determined by management judgement is applied at a portfolio level and is not included in the analysis above.

Note: The LGD can be higher for some better quality grades – this is because the Credit Quality Grades are set with reference to the PDs and not to the LGDs and the drivers of PD and LGD are different.

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



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

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

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

Emergence periods are reviewed on at least an annual basis. At 31 December 2016, there was no change made to the emergence period for the mortgage portfolio (12 months).

***Approval process\****

The AIB Group operates an approval framework for impairment provisions which are approved, depending on amount, by various delegated authorities and referred to Area Credit Committee level, as required. These committees are chaired by a designated Credit Risk representative as outlined in the terms of reference for Credit Committees (approved by ERC), where the valuation/impairment is reviewed and challenged for appropriateness and adequacy. Impairments in excess of the segment authorities are approved by the AIB Group Credit Committee and Board (where applicable). Segment impairments, mortgage model parameters and provisions are ultimately reviewed by the AIB Group Credit Committee as part of the quarterly process.

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

***Write-offs\****

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

***Reversals of impairment\****

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

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

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

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

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

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

*Loan loss provisioning (continued)**Impact of changes to key assumptions and estimates on the impairment provisions\* (continued)*

In assessing the value of collateral for collectively provided impaired mortgage loans in the Republic of Ireland, the Group has used a house price fall from peak of 40% Dublin and 44% non-Dublin as a base. This reflects a collateral value buffer against the latest available CSO residential property price index which at 31 December 2016 showed a 33% and a 37% fall from peak for Dublin and Non- Dublin respectively.

In 2016, the CSO moved to an enhanced estimation methodology for compiling movements in property prices. AIB's buffer to the latest available CSO index remained unchanged at 10% throughout 2016.

Sensitivity to changes in estimates and assumptions are detailed below:

A 1% favourable change in the cure rate used for the collective mortgage provisions would result in a reduction in impairment provisions of 0.5% (blended rate of owner-occupier/buy-to-let) or c. €1.5 million. December 2015 equivalent: reduction of 1.3% or c. €4m.

The value of collateral is estimated by applying changes in house price indices to the original assessed value of the property. A 1% change in the house price fall from peak assumption used for the collective mortgage provisions for December 2016 is estimated to result in movements in provisions of c. €3.7 million. December 2015 equivalent: €3.4m.

A 1% move in the haircut for a Dublin sale would result in a change of €0.96 million in provisions, (€0.87m Individually Insignificant and €0.1m IBNR). Dec 2015 equivalent: €0.84m (€0.73m II and €0.10m IBNR). A 1% move in the haircut for a sale outside Dublin would result in a change of €2.22 million in provisions, (€2.03m II and €0.2m IBNR). December 2015 equivalent: €1.88m (€1.67m II and €0.20m IBNR).

An increase in the assumed repossession rate of 1% for collective mortgage provisions would result in an increase in provisions of 0.8% (blended rate of owner-occupier/buy-to-let) or c. €2.5 million. December 2015 equivalent: increase of 0.6% or c. €1.8m.

An IBNR provision is made for impairments that have been incurred but have not been separately identifiable at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Bank's mortgage portfolio, the emergence period is currently 12 months; a decrease of one month in the loss emergence period in respect of the loan portfolio assessed would result in a decrease of c. €2 million. December 2015 equivalent: €3m.

Individually impaired loans by geographic location and sector*	2016 € m	2015 € m
Republic of Ireland		
Home Mortgages	753	965
	753	965

## Provision cover table

	Impaired Loan Balance	Specific Provision	Specific Provision Cover %
Home mortgages – 31 December 2016	753	258	34%
Home mortgages – 31 December 2015	965	253	26%

The increase in specific provision cover arises from provision top-ups on existing impaired loans, primarily from changes to model parameters and assumptions:

- (i) Reflecting the higher concentration of loans in the legal process, which take longer to resolve and typically require higher provision cover; and
- (ii) Reflecting revised estimates of outcome probabilities whereby a greater proportion of impaired loans are assigned a higher probability of disposal, which results in a higher provision estimate.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Loan loss provisioning (continued)**

The following pages provide details of:

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

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

**Statement of financial position\***

	2016			2015		
	Owner-Occupier € m	Buy-to-Let € m	Total € m	Owner-Occupier € m	Buy-to-Let € m	Total € m
Total gross residential mortgages	5,150	17	5,167	5,528	18	5,546
In arrears >30 days past due and/or impaired	777	7	784	994	9	1,003
In arrears >90 days past due and/or impaired	746	7	753	956	9	965
Of which impaired	746	7	753	956	9	965
Statement of financial position specific provisions	254	4	258	249	4	253
Statement of financial position IBNR provisions	29	-	29	28	-	28

Total impaired loans amounted to €753 million at 31 December 2016 (2015: €965 million), of which €27 million (2015: €85 million) was individually assessed for impairment and €726 million (2015: €880 million) was collectively assessed for impairment.

**Provision cover percentage\***

	2016			2015		
	Owner-Occupier %	Buy-to-Let %	Total %	Owner-Occupier %	Buy-to-Let %	Total %
Specific provisions as a % of impaired loans cover	34.0	57.1	34.3	26.0	44.4	26.2

Owner-occupier and Buy-to Let Specific Provision cover rates increased primarily due to parameter changes in the Mortgage Provisioning model.

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

	2016			2015		
	Owner-Occupier € m	Buy-to-Let € m	Total € m	Owner-Occupier € m	Buy-to-Let € m	Total € m
Income statement specific provisions	19	-	19	18	-	18
Income statement IBNR provisions	1	-	1	(28)	-	(28)
<b>Total impairment provisions</b>	<b>20</b>	<b>-</b>	<b>20</b>	<b>(10)</b>	<b>-</b>	<b>(10)</b>

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

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Asset quality of residential mortgages\*

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

	2016			2015		
	Owner-Occupier € m	Buy-to-Let € m	Total € m	Owner-Occupier € m	Buy-to-Let € m	Total € m
<b>Satisfactory</b>	<b>3,955</b>	<b>10</b>	<b>3,965</b>	<b>4,075</b>	<b>9</b>	<b>4,084</b>
Watch	403	-	403	431	-	431
Vulnerable	46	-	46	66	-	66
Impaired	746	7	753	956	9	965
<b>Criticised</b>	<b>1,195</b>	<b>7</b>	<b>1,202</b>	<b>1,453</b>	<b>9</b>	<b>1,462</b>
<b>Gross mortgages</b>	<b>5,150</b>	<b>17</b>	<b>5,167</b>	<b>5,528</b>	<b>18</b>	<b>5,546</b>
	%	%	%	%	%	%
Criticised loans as % of total mortgages	23.2	41.2	23.3	26.3	50.0	26.4
Impaired loans as % of total mortgages	14.5	41.2	14.6	17.3	50.0	17.4

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

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

The following tables show the fair value (FV) of collateral held for residential mortgages at 31 December 2016 and 31 December 2015:

	2016			
	Neither past due nor impaired € m	Past due but not impaired € m	Impaired € m	Total € m
<b>Fully collateralised</b>				
Loan-to-value ratio:				
Less than 50%	985	26	55	1,066
50%-70%	914	34	70	1,018
71%-80%	477	21	52	550
81%-90%	428	16	54	498
91%-100%	441	16	52	509
	3,245	113	283	3,641
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	877	39	344	1,260
<b>Total collateral value</b>	<b>4,122</b>	<b>152</b>	<b>627</b>	<b>4,901</b>
<b>Gross residential mortgages</b>	<b>4,254</b>	<b>160</b>	<b>753</b>	<b>5,167</b>
Statement of financial position specific provisions			(258)	(258)
Statement of financial position IBNR provisions				(29)
<b>Net residential mortgages</b>				<b>4,880</b>

The increase in the collateral values for impaired loans reflects residential property price increases during the year.

	2015			
	Neither past due nor impaired € m	Past due but not impaired € m	Impaired € m	Total € m
<b>Fully collateralised</b>				
Loan-to-value ratio:				
Less than 50%	948	27	76	1,051
50%-70%	834	32	107	973
71%-80%	520	20	70	610
81%-90%	478	22	84	584
91%-100%	469	17	71	557
	3,249	118	408	3,775
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	999	50	421	1,470
<b>Total collateral value</b>	<b>4,248</b>	<b>168</b>	<b>829</b>	<b>5,245</b>
<b>Gross residential mortgages</b>	<b>4,406</b>	<b>175</b>	<b>965</b>	<b>5,546</b>
Statement of financial position specific provisions			(253)	(253)
Statement of financial position IBNR provisions				(28)
<b>Net residential mortgages</b>				<b>5,265</b>

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Loans and receivables to customers – residential mortgages\* (continued)

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

## Arrears profile of mortgages which were past due but not impaired\*

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

The following tables profile the residential mortgage portfolio that was past due but not impaired at 31 December 2016 and 31 December 2015:

			2016
	Owner – Occupier € m	Buy-to-Let € m	Total € m
1 - 30 days	129	-	129
31 - 60 days	23	-	23
61 - 90 days	8	-	8
91 - 180 days	-	-	-
181 - 365 days	-	-	-
Over 365 days	-	-	-
<b>Total past due but not impaired</b>	<b>160</b>	<b>-</b>	<b>160</b>

			2015
	Owner – Occupier € m	Buy-to-Let € m	Total € m
1 - 30 days	137	-	137
31 - 60 days	25	-	25
61 - 90 days	13	-	13
91 - 180 days	-	-	-
181 - 365 days	-	-	-
Over 365 days	-	-	-
<b>Total past due but not impaired</b>	<b>175</b>	<b>-</b>	<b>175</b>

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Arrears profile of mortgages which were impaired\*

The following tables profile the residential mortgage portfolio that was impaired at 31 December 2016 and 31 December 2015:

	2016		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Not past due	159	-	159
1 - 30 days	36	1	37
31 - 60 days	16	-	16
61 - 90 days	13	-	13
91 - 180 days	47	-	47
181 - 365 days	47	1	48
Over 365 days	428	5	433
<b>Total impaired</b>	<b>746</b>	<b>7</b>	<b>753</b>

	2015		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Not past due	259	2	261
1 - 30 days	49	-	49
31 - 60 days	25	-	25
61 - 90 days	17	-	17
91 - 180 days	53	-	53
181 - 365 days	70	-	70
Over 365 days	483	7	490
<b>Total impaired</b>	<b>956</b>	<b>9</b>	<b>965</b>

Impaired loans decreased by €212m as restructuring and write offs exceeded newly impaired loans. New to impaired were significantly lower in 2016 compared to 2015 driven by an improved economic environment. Of the residential mortgage portfolio that was impaired at 31 December 2016, €159m or 21% was not past due (2015: €261m or 27%) of which €139m (2015: €214m) were subject to forbearance measures.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance

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

The following table analyses the movement in stock of loans subject to forbearance by (i) owner-occupier, (ii) buy-to-let and (iii) total residential mortgages at 31 December 2016 and 31 December 2015:

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

	2016		2015	
	Number	Balance €m	Number	Balance €m
At 1 January	8,619	1,048	8,026	950
Additions	1,018	142	1,954	271
Expired arrangements	(845)	(95)	(1,096)	(131)
Payments	-	(58)	-	(51)
Interest	-	31	-	30
Closed accounts <sup>(1)</sup>	(273)	(14)	(255)	(10)
Advanced Forbearance Arrangements - Valuation Adjustments	-	2	-	(3)
Write-Offs <sup>(2)</sup>	(4)	(1)	(7)	(7)
Transfer from owner-occupier to buy-to-let	-	-	(3)	(1)
Other movements	-	-	-	-
Adoption of EBA forbearance definition	(988)	(52)	-	-
<b>At 31 December</b>	<b>7,527</b>	<b>1,003</b>	<b>8,619</b>	<b>1,048</b>

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

	2016		2015	
	Number	Balance €m	Number	Balance €m
At 1 January	25	3	20	2
Additions	1	-	3	-
Expired arrangements	(5)	(1)	(1)	-
Payments	-	-	-	-
Interest	-	-	-	-
Closed accounts <sup>(1)</sup>	(3)	-	-	-
Advanced Forbearance Arrangements - Valuation Adjustments	-	-	-	-
Write-Offs <sup>(2)</sup>	-	-	-	-
Transfer from owner-occupier to buy-to-let	-	-	3	1
Other movements	-	-	-	-
Adoption of EBA forbearance definition	3	1	-	-
<b>At 31 December</b>	<b>21</b>	<b>3</b>	<b>25</b>	<b>3</b>

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

<sup>(2)</sup> Includes contracted and non-contracted write-offs in 2016 and 2015.

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



## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Total mortgage portfolio – subject to forbearance\*

	2016		2015	
	Number	Balance €m	Number	Balance €m
At 1 January	8,644	1,051	8,046	952
Additions	1,019	142	1,957	271
Expired arrangements	(850)	(96)	(1,097)	(131)
Payments	-	(58)	-	(51)
Interest	-	31	-	30
Closed accounts <sup>(1)</sup>	(276)	(14)	(255)	(10)
Advanced Forbearance Arrangements - Valuation Adjustments	-	2	-	(3)
Write-Offs <sup>(2)</sup>	(4)	(1)	(7)	(7)
Transfer from owner-occupier to buy-to-let	-	-	-	-
Other movements	-	-	-	-
Adoption of EBA forbearance definition	(985)	(51)	-	-
<b>At 31 December</b>	<b>7,548</b>	<b>1,006</b>	<b>8,644</b>	<b>1,051</b>

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

<sup>(2)</sup> Includes contracted and non-contracted write-offs in 2016 and 2015.

The stock of loans subject to forbearance measures decreased by €45 million in 2016 driven by a €51 million adjustment due to the adoption of a definition of forbearance as prescribed by the European Banking Authority and is mainly a reflection of the requirement to apply a probation period to loans subject to forbearance, which was not applied under the previous definition used.

Under the previous definition used, and which was prescribed by the Central Bank of Ireland, loans subject to temporary forbearance measures (e.g. interest only, payment moratoriums) remained in the forbearance stock only for the period of their temporary arrangement, whilst loans subject to permanent forbearance measures (e.g. term extension, arrears capitalisations) remained in the forbearance stock for a period of five years.

Under the EBA definition, all loans subject to forbearance measures remain in the forbearance stock for a period of 2 years from the date the forborne loan was considered "performing". This has led to a reduction in the forbearance stock as older permanent forbearance which have successfully exited probationary periods have not been fully offset by increases in the temporary forbearance measures still in their probationary period.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Residential owner-occupier mortgages\*

The following tables further analyse by type of forbearance, (i) owner-occupier, (ii) buy-to-let and (iii) total residential mortgages that were subject to forbearance measures at 31 December 2016 and 31 December 2015:

	2016					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance	Number	Balance € m
Interest only	1,663	248	1,016	164	647	84
Reduced payment (greater than interest only)	-	-	-	-	-	-
Payment moratorium	-	-	-	-	-	-
Low fixed interest rate	398	64	49	9	349	55
Arrears capitalisation	3,864	489	1,257	167	2,607	322
Term extension	204	17	39	4	165	13
Split mortgage	914	144	163	25	751	119
Sale for loss	124	6	66	5	58	1
Positive equity solution	360	35	15	1	345	34
Other						
<b>Total</b>	<b>7,527</b>	<b>1,003</b>	<b>2,605</b>	<b>375</b>	<b>4,922</b>	<b>628</b>

	2015					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	614	93	311	52	303	41
Reduced payment (greater than interest only)	-	-	-	-	-	-
Payment moratorium	-	-	-	-	-	-
Low fixed interest rate	456	70	29	6	427	64
Arrears capitalisation	5,088	612	2,015	251	3,073	361
Term extension	1,132	90	57	5	1,075	85
Split mortgage	901	146	357	60	544	86
Sale for loss	112	6	72	4	40	2
Positive equity solution	315	30	10	1	305	29
Other	1	1	-	-	1	1
<b>Total</b>	<b>8,619</b>	<b>1,048</b>	<b>2,851</b>	<b>379</b>	<b>5,768</b>	<b>669</b>

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Buy-to-let mortgages\*

2016

	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	5	1	2	1	3	-
Reduced payment (greater than interest only)	-	-	-	-	-	-
Payment moratorium	-	-	-	-	-	-
Low fixed interest rate	-	-	-	-	-	-
Arrears capitalisation	12	1	4	0	8	1
Term extension	-	-	-	-	-	-
Split mortgage	-	-	-	-	-	-
Sale for loss	4	1	3	0	1	1
Positive equity solution	-	-	-	-	-	-
Other	-	-	-	-	-	-
<b>Total</b>	<b>21</b>	<b>3</b>	<b>9</b>	<b>1</b>	<b>12</b>	<b>2</b>

2015

	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	1	-	1	-	-	-
Reduced payment (greater than interest only)	-	-	-	-	-	-
Payment moratorium	-	-	-	-	-	-
Low fixed interest rate	-	-	-	-	-	-
Arrears capitalisation	9	1	3	-	6	1
Term extension	10	1	1	-	9	1
Split mortgage	-	-	-	-	-	-
Sale for loss	5	1	5	1	-	-
Positive equity solution	-	-	-	-	-	-
Other	-	-	-	-	-	-
<b>Total</b>	<b>25</b>	<b>3</b>	<b>10</b>	<b>1</b>	<b>15</b>	<b>2</b>

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Total mortgage portfolio\*

2016						
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	1,668	249	1,018	165	650	84
Reduced payment (greater than interest only)	-	-	-	-	-	-
Payment moratorium	-	-	-	-	-	-
Low fixed interest rate	398	64	49	9	349	55
Arrears capitalisation	3,876	490	1,261	167	2,615	323
Term extension	204	17	39	4	165	13
Split mortgage	914	144	163	25	751	119
Sale for loss	128	7	69	5	59	2
Positive equity solution	360	35	15	1	345	34
Other	-	-	-	-	-	-
<b>Total</b>	<b>7,548</b>	<b>1,006</b>	<b>2,614</b>	<b>376</b>	<b>4,934</b>	<b>630</b>

2015						
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	615	93	312	52	303	41
Reduced payment (greater than interest only)	-	-	-	-	-	-
Payment moratorium	-	-	-	-	-	-
Low fixed interest rate	456	70	29	6	427	64
Arrears capitalisation	5,097	613	2,018	251	3,079	362
Term extension	1,142	91	58	5	1,084	86
Split mortgage	901	146	357	60	544	86
Sale for loss	117	7	77	5	40	2
Positive equity solution	315	30	10	1	305	29
Other	1	1	-	-	1	1
<b>Total</b>	<b>8,644</b>	<b>1,051</b>	<b>2,861</b>	<b>380</b>	<b>5,783</b>	<b>671</b>

A key feature of the forbearance portfolio is the increase in interest only and the reduction in the arrears capitalisation. This is due to the adoption of the definition of forbearance as prescribed by the EBA. Under the previous definition, loans subject to temporary forbearance measures (e.g. interest only, payment moratoriums) remained in the forbearance stock only for the period of their temporary arrangement, whilst loans subject to permanent forbearance measures (e.g. term extension, arrears capitalisations) remained in the forbearance stock for a period of five years. Under the EBA definition, loans subject to forbearance measures remain in the forbearance stock for a period of 2 years from the date the forbore loan was considered "performing".

Interest income on impaired loans amounted to €16.4 million in 2016. At 31 December 2016, the net carrying value of impaired loans amounted to €494 million (€753m Impaired Balance - €258m Closing Provision)(2015: €712 million) which included forbore impaired mortgages of €272 million (€376m Forborne Impaired Balance - €104m Forborne Closing Provision)(2015: €315 million).

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Credit profile of Residential Mortgages in Forbearance

## Forbearance stock - past due but not impaired\*

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

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was past due but not impaired at 31 December 2016 and 31 December 2015:

	2016		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
1 - 30 days	66	-	66
31 - 60 days	16	-	16
61 - 90 days	4	-	4
91 - 180 days	-	-	-
181 - 365 days	-	-	-
Over 365 days	-	-	-
<b>Total past due but not impaired</b>	<b>86</b>	<b>-</b>	<b>86</b>

	2015		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
1 - 30 days	67	-	67
31 - 60 days	15	-	15
61 - 90 days	7	-	7
91 - 180 days	-	-	-
181 - 365 days	-	-	-
Over 365 days	-	-	-
<b>Total past due but not impaired</b>	<b>89</b>	<b>-</b>	<b>89</b>

9% of the residential mortgage portfolio that was subject to forbearance measures was past due but not impaired at 31 December 2016 (31 December 2015: 8%).

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Credit profile of Residential Mortgages in Forbearance

## Forbearance stock – impaired\*

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was impaired at 31 December 2016 and 31 December 2015:

	2016		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Not past due	139	-	139
1 - 30 days	32	-	32
31 - 60 days	12	-	12
61 - 90 days	10	-	10
91 - 180 days	33	-	33
181 - 365 days	33	-	33
Over 365 days	116	1	117
<b>Total impaired</b>	<b>375</b>	<b>1</b>	<b>376</b>

	2015		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Not past due	213	1	214
1 - 30 days	38	-	38
31 - 60 days	17	-	17
61 - 90 days	11	-	11
91 - 180 days	30	-	30
181 - 365 days	22	-	22
Over 365 days	48	-	48
<b>Total impaired</b>	<b>379</b>	<b>1</b>	<b>380</b>

The proportion of forbearance that is impaired increased from 36% at 31 December 2015 to 37% at 31 December 2016. The proportion of forborne impaired loans that were not past due decreased from 56% at 31 December 2015 to 37% at 31 December 2016, mainly due to the change in stock as a result of the adoption of a definition of forbearance as prescribed by the European Banking Authority.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

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

The following table profiles the residential mortgage portfolio that was subject to forbearance measures by the indexed loan-to-value ratios at 31 December 2016 and 31 December 2015:

Loan-to-value (LTV) ratio:	2016		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	135	-	135
50% - 70%	179	-	179
71% - 80%	114	-	114
81% - 90%	108	-	108
91% - 100%	85	1	86
101% - 120%	181	1	182
121% - 150%	173	-	173
Greater than 150%	20	-	20
Unsecured (Zero Collateral)	8	1	9
<b>Total forbearance</b>	<b>1,003</b>	<b>3</b>	<b>1,006</b>

Loan-to-value (LTV) ratio:	2015		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	158	1	159
50% - 70%	195	-	195
71% - 80%	117	-	117
81% - 90%	118	-	118
91% - 100%	89	-	89
101% - 120%	179	1	180
121% - 150%	174	-	174
Greater than 150%	12	-	12
Unsecured (Zero Collateral)	6	1	7
<b>Total forbearance</b>	<b>1,048</b>	<b>3</b>	<b>1,051</b>

## Properties in possession\*

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

For the purpose of the following table, a residential property is considered to be in EBSMF's possession when it has taken possession of and is in a position to dispose of the property. This includes situations of repossession, voluntary surrender and abandonment of the property.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit Risk (continued)

## Properties in possession\* (continued)

The number (stock) of repossessions as at 31 December 2016 and 31 December 2015 is set out below:

	2016		2015	
	Stock	Balance Outstanding €m	Stock	Balance Outstanding €m
Owner-occupier	210	52	176	43
Buy-to-let	4	1	4	1
<b>Total</b>	<b>214</b>	<b>53</b>	<b>180</b>	<b>44</b>

The increase in the stock of properties in 2016 relates to 89 properties repossessed offset by 55 disposals. There continues to be an increase in stock due to continued focus on arrears management.

The following tables analyse the disposals of repossessed properties during the years 31 December 2016 and 31 December 2015:

	2016					
	Number of Disposals	Balance outstanding at repossession date € m	Gross sales proceeds € m	Costs to sell € m	Loss on sale <sup>(1)</sup> € m	Average LTV at sale Price %
Owner-occupier	53	14	7	1	8	205%
Buy-to-let	2	1	-	-	1	383%
<b>Total residential</b>	<b>55</b>	<b>15</b>	<b>7</b>	<b>1</b>	<b>9</b>	<b>214%</b>

	2015					
	Number of Disposals	Balance outstanding at repossession date € m	Gross sales proceeds € m	Costs to sell € m	Loss on sale <sup>(1)</sup> € m	Average LTV at sale Price %
Owner-occupier	124	34	14	1	21	240%
Buy-to-let	2	1	-	-	-	271%
<b>Total residential</b>	<b>126</b>	<b>35</b>	<b>14</b>	<b>1</b>	<b>21</b>	<b>250%</b>

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

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

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

The disposal of 55 residential properties resulted in a loss on disposal of €9 million at 31 December 2016 (before specific impairment provisions), (2015: 126 disposals, and €21 million loss on disposal).

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

The property values used in the completion of the following loan-to-value tables are determined with reference to the original or most recent valuation, indexed to the Central Statistics Office ("CSO") Residential Property Price Index in the Republic of Ireland for October 2016. The CSO Residential Property Price Index for October 2016 reported that national residential property prices were 31.5% lower than their highest level in early 2007 and reported an annual increase in residential property prices of 8.6% for the twelve months to October 2016.

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



## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Actual and average LTV across mortgage portfolios\*

The following tables profile the residential mortgage portfolio by the indexed loan-to-value ('LTV') ratios and the weighted average indexed LTV ratios at 31 December 2016 and 31 December 2015:

Loan-to-value (LTV) ratio:	2016		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	1,065	1	1,066
50% - 70%	1,017	2	1,019
71% - 80%	548	2	550
81% - 90%	497	1	498
91% - 100%	507	2	509
101% - 120%	811	4	815
121% - 150%	553	2	555
Greater than 150%	115	1	116
Unsecured (Zero Collateral)	37	2	39
<b>Total</b>	<b>5,150</b>	<b>17</b>	<b>5,167</b>
Weighted average indexed LTV <sup>(1)</sup>			
Stock of residential mortgages at year end	80%	95%	80%
New residential mortgages during year	-	-	-
Impaired mortgages	109%	113%	109%

Loan-to-value (LTV) ratio:	2015		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	1,049	1	1,050
50% - 70%	971	2	973
71% - 80%	609	2	611
81% - 90%	583	1	584
91% - 100%	556	1	557
101% - 120%	862	6	868
121% - 150%	748	3	751
Greater than 150%	124	1	125
Unsecured (Zero Collateral)	26	1	27
<b>Total</b>	<b>5,528</b>	<b>18</b>	<b>5,546</b>
Weighted average indexed LTV <sup>(1)</sup>			
Stock of residential mortgages at year end	82%	98%	82%
New residential mortgages during year	-	-	-
Impaired mortgages	106%	111%	106%

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

29% of the total owner-occupier and 53% of the total buy-to-let mortgages were in negative equity at 31 December 2016, compared to 32% and 61% respectively at 31 December 2015. The weighted average indexed loan-to-value for the total residential mortgage book was 80% at 31 December 2016 compared to 82% at 31 December 2015, with the reduction driven primarily by the increase in property prices in 2016, coupled with amortisation of the loan book and restructuring activity.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Neither past due nor impaired\*

The following tables profile the residential mortgage portfolio that was neither past due nor impaired by the indexed loan to value ratios at 31 December 2016 and 31 December 2015:

Loan-to-value (LTV) ratio:	2016		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	985	1	986
50% - 70%	913	1	914
71% - 80%	476	1	477
81% - 90%	427	1	428
91% - 100%	440	1	441
101% -120%	655	2	657
121% - 150%	346	1	347
Greater than 150%	3	-	3
Unsecured (Zero Collateral)	1	-	1
<b>Total</b>	<b>4,246</b>	<b>8</b>	<b>4,254</b>

Loan-to-value (LTV) ratio:	2015		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	948	1	949
50% - 70%	833	1	834
71% - 80%	519	2	521
81% - 90%	478	1	479
91% - 100%	468	-	468
101% -120%	678	3	681
121% - 150%	470	1	471
Greater than 150%	2	-	2
Unsecured (Zero Collateral)	1	-	1
<b>Total</b>	<b>4,397</b>	<b>9</b>	<b>4,406</b>

The proportion of residential mortgages that were neither past due nor impaired and in negative equity at 31 December 2016 decreased in comparison to 31 December 2015, reflecting the increases in residential property prices in the period, coupled with amortisation of the loan book. 23.7% of residential mortgages that were neither past due nor impaired were in negative equity at 31 December 2016 compared to 26% at 31 December 2015.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Past due but not impaired\*

The following tables profile the residential mortgage portfolio that was past due but not impaired at 31 December 2016 and 31 December 2015:

Loan-to-value (LTV) ratio:	2016		
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	27	-	27
50% - 70%	34	-	34
71% - 80%	21	-	21
81% - 90%	16	-	16
91% - 100%	16	-	16
101% - 120%	25	-	25
121% - 150%	20	-	20
Greater than 150%	-	-	-
Unsecured (Zero Collateral)	1	-	1
<b>Total</b>	<b>160</b>	<b>-</b>	<b>160</b>

Loan-to-value (LTV) ratio:	2015		
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	27	-	27
50% - 70%	32	-	32
71% - 80%	20	-	20
81% - 90%	22	-	22
91% - 100%	17	-	17
101% - 120%	32	-	32
121% - 150%	25	-	25
Greater than 150%	-	-	-
Unsecured (Zero Collateral)	-	-	-
<b>Total</b>	<b>175</b>	<b>-</b>	<b>175</b>

Of the residential mortgages that were past due but not impaired at 31 December 2016, 29% were in negative equity at 31 December 2016 compared to 33% at 31 December 2015.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

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

The following tables profile the residential mortgage portfolio that was greater than 90 days past due and/or impaired by the indexed LTV ratios at 31 December 2016 and 31 December 2015:

Loan-to-value (LTV) ratio:	2016		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	55	-	55
50% - 70%	70	-	70
71% - 80%	52	-	52
81% - 90%	54	-	54
91% - 100%	51	1	52
101% - 120%	131	2	133
121% - 150%	187	1	188
Greater than 150%	112	1	113
Unsecured (Zero Collateral)	34	2	36
<b>Total</b>	<b>746</b>	<b>7</b>	<b>753</b>

Loan-to-value (LTV) ratio:	2015		
	Owner – Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
Less than 50%	75	-	75
50% - 70%	106	1	107
71% - 80%	70	1	71
81% - 90%	83	1	84
91% - 100%	71	-	71
101% - 120%	152	2	154
121% - 150%	253	2	255
Greater than 150%	121	1	122
Unsecured (Zero Collateral)	25	1	26
<b>Total</b>	<b>956</b>	<b>9</b>	<b>965</b>

The proportion of residential mortgages that were greater than 90 days past due and/or impaired and in negative equity at 31 December 2016 (62%) increased in comparison to 31 December 2015 (58%). Total loans greater than 90 days past due and/or impaired has decreased by 22%.

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

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Residential Mortgages by year of origination\*

The following tables profile the residential mortgage portfolio and impaired residential mortgage portfolio at 31 December 2016 and 2015 by year of origination:

	2016			
	Mortgage portfolio		Impaired mortgage portfolio	
	Number	Balance € m	Number	Balance € m
1996 and before	1,410	51	103	5
1997	759	15	40	2
1998	783	21	49	3
1999	902	31	51	3
2000	1,123	57	78	7
2001	1,422	94	93	9
2002	2,048	159	127	12
2003	2,331	177	194	19
2004	2,700	240	217	25
2005	4,025	398	367	55
2006	6,908	959	847	157
2007	6,741	998	1,190	220
2008	6,254	880	921	159
2009	3,970	505	347	51
2010	3,962	538	165	24
2011	363	44	11	2
2012	-	-	-	-
2013	-	-	-	-
2014	-	-	-	-
2015	-	-	-	-
2016	-	-	-	-
<b>Total</b>	<b>45,701</b>	<b>5,167</b>	<b>4,800</b>	<b>753</b>

	2015			
	Mortgage portfolio		Impaired mortgage portfolio	
	Number	Balance € m	Number	Balance € m
1996 and before	1,997	62	177	8
1997	859	20	59	2
1998	867	26	76	5
1999	986	37	85	6
2000	1,203	65	115	9
2001	1,582	107	131	12
2002	2,195	177	172	18
2003	2,477	197	272	28
2004	2,858	262	277	32
2005	4,242	431	504	74
2006	7,321	1,025	1,106	197
2007	6,980	1,053	1,473	270
2008	6,505	940	1,230	205
2009	4,156	531	454	62
2010	4,155	566	239	36
2011	392	47	8	1
2012	-	-	-	-
2013	-	-	-	-
2014	-	-	-	-
2015	-	-	-	-
<b>Total</b>	<b>48,775</b>	<b>5,546</b>	<b>6,378</b>	<b>965</b>

The majority (€3.2bn or 63%) of the €5.2bn residential mortgage portfolio was originated between 2005 and 2008, of which 18% (€0.6bn) was impaired at 31 December 2016. This cohort was impacted by reduced household income and increased unemployment rates in those years, and where property prices had decreased from a peak in 2007. 16% of the residential mortgage portfolio was originated before 2005 of which 10% was impaired at 31 December 2016, while the remaining 21% of the portfolio was originated since 2009 or after, of which 7% was impaired at 31 December 2016.

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

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)****Further information on credit risk**

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

- Impairment of loans and receivables (*note 8*);
- Derivatives financial instruments (*note 11*);
- Loans and receivables to banks (*note 12*);
- Loans and receivables to customers (*note 13*).

**3.2 Restructure execution risk**

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

The AIB Group continues to have a relatively high level of problem or criticised loans, which are defined as loans requiring additional management attention over and above that normally required for the loan type. The AIB Group has been proactive in managing its criticised loans through a restructuring process. The objective of this process is to assist customers that find themselves in financial difficulties and to deal with them sympathetically and to work with them constructively and to explore appropriate solutions. By continuing to work together in this process, the AIB Group and the customer can find a mutually acceptable and alternative way forward. These plans, if successfully completed, will materially change the make-up of the AIB Group's operations. It will remove non-performing assets from the bank's balance sheet, improve its asset quality, lower its overall risk profile, and strengthen its solvency.

However, as AIB Group moves forward into the post-restructure phase, the realisation of collateral and the receipt of expected cashflows within the timeframes estimated, presents a level of execution risk. In addition, there is the risk of customers re-defaulting post restructure.

AIB Group has extensive credit policies and strategies, implementation guidelines and monitoring structures in place to manage and to assist with the restructuring of problem loans. AIB Group regularly reviews the performance of these restructured loans and has a dedicated team to focus on asset sales within the restructured portfolio.

**3.3 Funding and liquidity risk**

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

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

EBS MF's liquidity risk is managed as part of the overall AIB Group liquidity management. In accordance with the Capital Requirements Regulation ("CRR"), the Bank has appointed AIB as its liquidity manager to fulfil daily cash flow management, oversee any changes required in liquidity management or reporting and manage the Bank's liquidity risk as part of the overall AIB liquidity risk management process. This includes the risk identification and assessment, risk management and mitigation, and risk monitoring and reporting processes. Under this centralised approach the management of liquidity and related activities for EBS MF is integrated with its parent, the AIB Group.

The means by which these liquidity management activities are performed, and the procedures by which AIB ensures the Bank complies with the AIB Group Liquidity Policy are managed through Master Service Agreements ("MSA").

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

- the issuance of Mortgage Asset Covered Securities in accordance with the ACS Act;
- inter Group funding facilities;
- secured funding via sale and repurchase agreements, or otherwise posting as collateral the bank's self-issued securities for value with AIB and/or the Central Bank;
- borrowing from the Central Bank by a way of mortgage backed promissory note facilities as agreed between both parties from time to time;
- ordinary share capital;
- other funding sources.

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

**RISK MANAGEMENT REPORT (CONTINUED)****3.3 Funding and liquidity risk (continued)**

While the majority of the bank's funding has and will continue to be sourced from the above categories there are other potential sources such as subordinated capital or deposits from other AIB Group entities. EBS MF does not actively seek customer deposits.

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

***Risk identification and assessment***

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

***Risk management and mitigation***

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

The Group operates a three lines of defence model for risk management. In terms for Funding & Liquidity Risk the first line comprises the Capital and Liquidity and Treasury functions. The Group's Capital and Liquidity unit, reporting to the CFO, is the owner of the Group's Funding and Liquidity plan which sets out the strategy for funding and liquidity management for the Group and is responsible for the management of the Group's liquidity gap and the efficient management of the liquidity buffer. This involves the identification, measurement and reporting of funding and liquidity risk, the valuation of financial assets for collateral and the application of behavioural adjustments to assets and liabilities.

The Group's Treasury segment is responsible for the day to day management of liquidity to meet payment obligations, execution of wholesale funding requirements in line with the Funding and Liquidity Plan and the management of the FX funding gap.

First line management of funding and liquidity risk consists of:

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

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

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

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

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.3 Funding and liquidity risk (continued)

**Risk monitoring and reporting\***

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

**Liquidity risk stress testing**

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

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

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

**Financial liabilities by contractual maturity\***

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

	2016					
	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Deposits by Banks	-	2,674	-	-	-	2,674
Derivative financial instruments	-	-	-	-	18	18
Debt securities in issue	-	-	-	500	1,000	1,500
<b>Total</b>	<b>-</b>	<b>2,674</b>	<b>-</b>	<b>500</b>	<b>1,018</b>	<b>4,192</b>

	2015					
	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Total
	€ m	€ m	€ m	€ m	€ m	€ m
Deposits by Banks	-	2,271	-	-	-	2,271
Derivative financial instruments	-	-	-	-	20	20
Debt securities in issue	-	425	666	796	500	2,387
<b>Total</b>	<b>-</b>	<b>2,696</b>	<b>666</b>	<b>796</b>	<b>520</b>	<b>4,678</b>

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



**RISK MANAGEMENT REPORT (CONTINUED)****3.3 Funding and liquidity risk\* (continued)****Encumbrance**

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

EBSMF had an encumbrance ratio of 41% at 31 December 2016 (2015: 40%). The encumbrance level is based on the amount of assets that are required in order to meet regulatory and contractual commitments.

**3.4 Capital adequacy risk**

Capital adequacy risk is defined as the risk that EBSMF or AIB Group breaches or may breach regulatory capital ratios and internal targets. The key material risks impacting on the capital adequacy position of EBSMF or AIB Group is credit risk, although it should be noted that all material risks can to some degree impact capital ratios.

Capital Adequacy Risk is mitigated at AIB Group level by an evaluation of the adequacy of the AIB Group's capital under both forecast and stress conditions as part of the Internal Capital Adequacy Assessment Process ("ICAAP"). The ICAAP process includes the identification and evaluation of potential capital mitigants. The objectives of the AIB Group's capital management policy are to comply at all times with all applicable regulatory capital requirements (including requirements at EBS Mortgage Finance level) and to ensure that EBSMF has sufficient capital to cover current and potential future risks to its business.

Further details of AIB Group's capital position and the management thereof can be found in the capital management section of the Business review in the 2016 AIB Group Annual Financial Report.

**3.5 Market risk\***

Market risk is the risk relating to the uncertainty of returns attributable to fluctuations in market factors. Where the uncertainty is expressed as a potential loss in earnings or value, it represents a risk to the income and capital position of the Bank.

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

EBS MF is exposed to interest rate risk arising from mortgage lending activities and the issuance of Mortgage Covered Securities. Interest rate swaps, as explained in the paragraphs below, are used to manage this exposure. The Bank is not allowed to engage in proprietary trading under the conditions of the Asset Covered Securities Act and its license. The interest rate exposure of the Bank relating to its Irish residential lending is managed using two macro interest rate swaps with Allied Irish Banks, p.l.c. one of which, the Pool Hedge, relates only to the Pool and Mortgage Covered Securities issued by the Bank and the other of which (the Non-Pool Hedge) relates only to Irish residential loans which are not included in the Pool. This split is required by the Asset Covered Securities Acts.

The Pool Hedge and the Non-Pool Hedge contracts entail the monthly payment of the average customer rate on these mortgages and in return, the receipt of 1 month Euribor plus the current margin being achieved on the mortgage portfolio. The contract is reset each month to reflect the outstanding mortgage balances at that time and to reflect updated customer rates, Euribor and margin levels. Settlements are made between the Bank and Allied Irish Banks, p.l.c. to reflect the net amount payable/receivable in each month.

There is some residual interest rate risk in EBSMF. This interest rate risk is transferred to and managed by Treasury, subject to Capital and Liquidity review and oversight by ALCo. Treasury proactively manages the market risk on the Group's balance sheet. Market risk is managed against a range of limits approved at ALCo, which incorporate forward-looking measures such as VaR limits and stress test limits and financial measures such as 'stop-loss' and embedded value limits. Treasury documents an annual Risk Strategy and Appetite Statement as part of the annual financial planning cycle which ensures Treasury's market risk aligns with the Group's strategic business plan. Interest rate swaps are used solely for risk management and not trading purposes.

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

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

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.5 Market risk\* (continued)

## Interest Rate Exposure and Sensitivity\*

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

Assets	0≤1 mth	1≤3 mths	3≤12 mths	1≤2 yrs	2≤3 yrs	3≤4 yrs	4≤5 yrs	5 yrs+	Non-interest bearing	Total
	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Loans and receivables to customers	4,810	20	108	79	29	58	47	17	(288)	4,880
Loans and receivables to banks	49	-	-	-	-	-	-	-	-	49
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	19	19
Other assets	-	-	-	-	-	-	-	-	5	5
<b>Total Assets</b>	<b>4,859</b>	<b>20</b>	<b>108</b>	<b>79</b>	<b>29</b>	<b>58</b>	<b>47</b>	<b>17</b>	<b>(264)</b>	<b>4,953</b>
<b>Liabilities</b>										
Deposits by banks	2,674	-	-	-	-	-	-	-	-	2,674
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	18	18
Debt issued	1,500	-	-	-	-	-	-	-	-	1,500
Other liabilities	-	-	-	-	-	-	-	-	14	14
Shareholders' equity	-	-	-	-	-	-	-	-	747	747
<b>Total Liabilities</b>	<b>4,174</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>779</b>	<b>4,953</b>
<b>Derivatives financial instruments (interest rate swaps)</b>										
Floating rate interest receivable	(5,285)	-	-	-	-	-	-	-	-	(5,285)
Floating rate interest payable	4,927	20	108	79	29	58	47	17	-	5,285
<b>Total derivatives</b>	<b>(358)</b>	<b>20</b>	<b>108</b>	<b>79</b>	<b>29</b>	<b>58</b>	<b>47</b>	<b>17</b>	<b>-</b>	<b>-</b>
<b>Interest sensitivity gap</b>	<b>1,043</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(1,043)</b>	<b>-</b>
<b>Cumulative interest sensitivity gap</b>	<b>1,043</b>	<b>1,043</b>	<b>1,043</b>	<b>1,043</b>	<b>1,043</b>	<b>1,043</b>	<b>1,043</b>	<b>1,043</b>	<b>-</b>	<b>-</b>

The impact on net interest income over a twelve month period of a 100 basis point ("bps") downward/upward movement in interest rates on 31 December 2016 would be a loss of -€1,847k/-€2,771k respectively.

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

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.5 Market risk\* (continued)

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

The net interest rate exposure of EBS Mortgage Finance at 31 December 2015 analysed by the earlier of the repricing and the contractual maturity date is illustrated in the following table:

Assets	0≤1 mth	1≤3 mths	3≤12 mths	1≤2 yrs	2≤3 yrs	3≤4 yrs	4≤5 yrs	5 yrs+	Non-interest bearing	Total
	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Loans and receivables to customers	5,036	40	154	105	84	21	60	46	(281)	5,265
Loans and receivables to banks	60	-	-	-	-	-	-	-	-	60
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	20	20
Other assets	-	-	-	-	-	-	-	-	2	2
<b>Total Assets</b>	<b>5,096</b>	<b>40</b>	<b>154</b>	<b>105</b>	<b>84</b>	<b>21</b>	<b>60</b>	<b>46</b>	<b>(259)</b>	<b>5,347</b>
<b>Liabilities</b>										
Deposits by banks	2,271	-	-	-	-	-	-	-	-	2,271
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	20	20
Debt issued	2,387	-	-	-	-	-	-	-	-	2,387
Other liabilities	-	-	-	-	-	-	-	-	43	43
Shareholders' equity	-	-	-	-	-	-	-	-	626	626
<b>Total Liabilities</b>	<b>4,658</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>689</b>	<b>5,347</b>
<b>Derivatives financial instruments</b>										
(interest rate swaps)										
Floating rate interest receivable	(5,707)	-	-	-	-	-	-	-	-	(5,707)
Floating rate interest payable	5,197	40	154	105	84	21	60	46	-	5,707
<b>Total derivatives</b>	<b>(510)</b>	<b>40</b>	<b>154</b>	<b>105</b>	<b>84</b>	<b>21</b>	<b>60</b>	<b>46</b>	<b>-</b>	<b>-</b>
<b>Interest sensitivity gap</b>	<b>948</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(948)</b>	<b>-</b>
<b>Cumulative interest sensitivity gap</b>	<b>948</b>	<b>948</b>	<b>948</b>	<b>948</b>	<b>948</b>	<b>948</b>	<b>948</b>	<b>948</b>	<b>-</b>	<b>-</b>

The impact on net interest income over a twelve month period of a 100 basis point ("bps") downward/upward movement in interest rates on 31 December 2015 would be circa -€2,034k/€2,915k respectively

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

**RISK MANAGEMENT REPORT (CONTINUED)****3.6 Operational risk\***

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

The key people, systems and processes supporting EBSMF are provided by AIB Group and this relationship is governed by a Managed Services Agreement. The AIB Group's operational risk framework applies across all areas of AIB Group including EBS Limited and the Bank. The AIB Group Operational Risk function is responsible for overseeing the management of operational risk across AIB Group. A key focus of operational risk management in EBSMF is the oversight of outsourced service activities, in particular activities related to the requirements of the ACS Act.

EBSMF undertakes an operational risk self-assessment which focuses on activities specific to the Bank e.g. the Bank's funding activities and its compliance with the ACS Act. This process includes periodic assessments of relevant operational risks and the effectiveness of the related controls to address these risks. It complements the risk-based audit approach applied by internal audit in its role as independent assessor of management's control and risk management processes.

**3.7 Regulatory compliance risk and conduct risk\***

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

The level of regulatory risk remained high in 2016 as the regulatory landscape for the banking sector continued to evolve with a continuing focus on supporting the stability of the banking system and ensuring the provision of customer focussed financial services. EBS Mortgage Finance is committed to proactively identifying regulatory and compliance obligations arising in its operating markets in Ireland, and ensuring the timely implementation of regulatory change. Throughout 2016, projects were mobilised within AIB Group to prepare for the significant regulatory change horizon as outlined in AIB Group's annual report: Governance and Oversight – Supervision and Regulation.

The level of regulatory change is expected to continue in 2017.

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

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

**3.8 Culture risk**

Culture Risk is the risk that intentional or unintentional behaviours or actions taken by employees which are not conducive with the overall strategy, culture and values of AIB Group will adversely impact business performance or prospects.

**Mitigating actions**

Culture is an essential component in realising an organisations strategic ambitions. An effective culture is built around a general principle of "doing the right thing" for all stakeholders, including customers, staff and regulators.

AIB seeks to foster a consistent culture, in the way decision making occurs and how AIB communicate this from the top and throughout the AIB Group. In this way AIB has embedded a set of customer centric Brand Values. These values drive and influence activities of all staff, guiding our dealings with customers, each other and all stakeholders. AIB's Brand Values are embedded within the AIB Group's framework, from the way AIB recruit, promote, reward and manage our people.

A strong Culture demonstrates a consistent approach to compliance in both the letter and spirit of the law. AIB's Risk Culture Principles and Code of Conduct places great emphasis on the integrity of staff and accountability for both inaction and actions taken. These frameworks describe for staff the standards AIB apply that translate into how AIB behave.

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

**RISK MANAGEMENT REPORT (CONTINUED)****3.8 Culture risk (continued)****Mitigating actions (continued)**

How AIB lives up to the values determines what behaviours are acceptable in AIB and this means aligning remunerations and reward models around these values. In 2016 AIB launched the Aspire Performance Management Programme ("Aspire") to facilitate quality performance discussions that contribute to delivering the Groups strategic ambitions. Aspire allows all staff to create goals that are clear on "What" they will achieve and that "How" they behave will be important to deliver these goals. This means that AIB stands out from its peers in embracing the right behaviours and outcomes with equal weighting, in achieving our strategic ambition.

AIB has made significant steps in increasing engagement and awareness of AIB's Risk management activities throughout the AIB Group by embedding the Risk Appetite Statement in policies and frameworks of the AIB Group. The Risk Appetite Statement contains clear statements of intent as to AIB's attitude to taking and managing risk, including culture risk. It ensures AIB monitor and report against certain culture metrics in measuring culture risk and tracking cultural change.

AIB closely monitors the evolving culture at an AIB Group level through our staff engagement programme, iConnect. Engagement scores have consistently increased since its inception 2013. As a result, initiatives continue to be undertaken at team level to improve the way AIB do things and from which AIB continuously identify opportunities to evolve the culture at AIB Group level as a competitive advantage.

AIB's iLearn training portal, provides all staff with dedicated and bespoke curriculum that allow teams and individuals to invest in themselves and therefore the organisation. AIB's Speak Up Policy and process also provides staff with a protected channel for raising concerns which is at the heart fostering an open and receptive cultural environment.

**3.9 Business risk**

Business risk is defined as the risk that external and internal factors impact on the AIB Group's performance and the achievement of its strategic objectives. External factors include the macro-economic, geo-political and competitive environment. Internal factors include plan delivery, cost management and execution/change management.

Competition risk, which is a component of business risk, is the risk that the actions of competitors or new entrants to the market impair the AIB Group's competitive position, threaten the viability of its business model or even its ability to survive.

**Risk identification and assessment**

AIB identifies and assesses business risk as part of its integrated planning process, which encapsulates strategic, business and financial planning. This process drives delivery of AIB's strategic objectives aligned to the AIB Group's risk appetite and enables measurable business objectives to be set for management aligned to the short, medium and long-term strategy of the AIB Group.

The AIB Group reviews its assumptions on its external operating environment and, by extension, its strategic objectives on a periodic basis, the frequency of which is determined by a number of factors including the speed of change of the economic environment, changes in the financial services industry and the competitive landscape, regulatory change and deviations in actual business outturn from strategic targets. In normal circumstances, this is annually.

The AIB Group's business and financial planning process supports the AIB Group's strategy. Every year, the AIB Group prepares three- year business plans at an AIB Group level based on macro-economic and market forecasts across a range of scenarios. The plan includes an evaluation of planned performance against a suite of key metrics, supported by detailed analysis and commentary on underlying trends and drivers, across P&L, balance sheet and business targets. This assessment includes, but is not limited to discussion on new lending volumes and pricing, deposits volumes and pricing, other income, cost management initiatives and credit performance. The AIB Group plan is supported by detailed business unit plans, encapsulating the operations and activities of EBSMF. Each business unit plan is aligned to the AIB Group strategy and risk appetite. The business plan typically describes the market in which the segment operates, market and competitor dynamics, business strategy, financial assumptions underpinning the strategy, actions/investment required to achieve financial outcomes and any risks/opportunities to the strategy.

**Risk management & mitigation**

At a strategic level, EBSMF manages business risk within its risk appetite framework, by setting limits in respect of measures such as financial performance, portfolio concentration and risk-adjusted return. At a more operational level, the risk is mitigated through periodic monitoring of variances to plan at both AIB Group and EBSMF level where performance against Plan is outside agreed tolerances or risk appetite metrics, proposed mitigating actions are presented and evaluated, and tracked thereafter. During the year, periodic forecast updates for the full year financial outcome may also be produced. The frequency of forecast updates during each year will be determined based on prevailing business conditions.

**RISK MANAGEMENT REPORT (CONTINUED)****3.9 Business risk (continued)****Risk monitoring and reporting**

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

**3.10 Model risk**

Model Risk is the risk of potential adverse consequences from decisions based on incorrect or misused model outputs and reports. The responsibilities and accountabilities in relation to the governance of model risk is outlined in the AIB Group's Model Risk Framework.

The AIB Group mitigates model risk by having policies and standards in place in relation to model development, operation and validation. In addition, AIB Group Internal Audit provide independent assurance on the adequacy, effectiveness and sustainability of the governance, risk management and control framework supporting model risk through their periodic review of the Model Risk Management processes.

**STATEMENT OF DIRECTORS' RESPONSIBILITIES**

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

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

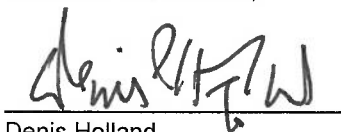
In preparing these financial statements, the Directors are required to:

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

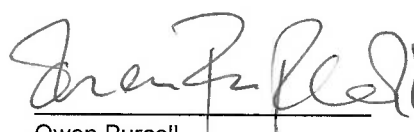
The Directors are responsible for ensuring that the Bank keeps or causes to be kept adequate accounting records which correctly explain and record the transactions of the Bank, enable at any time the assets, liabilities, financial position and profit or loss of the Bank to be determined with reasonable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

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

On behalf of the Board,



Denis Holland  
Chairman



Owen Purcell  
Managing Director

Date: 30 March 2017

## **INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF EBS MORTGAGE FINANCE**

We have audited the financial statements of EBS Mortgage Finance for the financial year ended 31 December 2016 which comprise the Income Statement, the Statement of Comprehensive Income, the Statement of Financial Position, the Statement of Cash Flows, the Statement of Changes in Shareholders' Equity and the related notes 1 to 26. The relevant financial reporting framework that has been applied in their preparation is the Companies Act 2014 and International Financial Reporting Standards (IFRS) as adopted by the European Union ("relevant financial reporting framework").

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

### **Respective responsibilities of directors and auditors**

As explained more fully in the Statement of Directors' Responsibilities, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and otherwise comply with the Companies Act 2014. Our responsibility is to audit and express an opinion on the financial statements in accordance with the Companies Act 2014 and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

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

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

### **Opinion on financial statements**

In our opinion, the financial statements:

- give a true and fair view of the assets, liabilities and financial position of the company as at 31 December 2016 and of the profit for the financial year then ended; and
- have been properly prepared in accordance with the relevant financial reporting framework and, in particular, with the requirements of the Companies Act 2014.

### **Matters on which we are required to report by the Companies Act 2014**

- We have obtained all the information and explanations which we consider necessary for the purposes of our audit.
- In our opinion the accounting records of the company were sufficient to permit the financial statements to be readily and properly audited.
- The financial statements are in agreement with the accounting records.
- In our opinion the information given in the directors' report is consistent with the financial statements.

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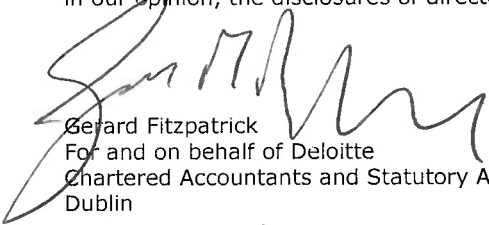


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**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF  
EBS MORTGAGE FINANCE**

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

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



Gerard Fitzpatrick  
For and on behalf of Deloitte  
Chartered Accountants and Statutory Audit Firm  
Dublin

Date: 30/3/2017

## INCOME STATEMENT

For the financial year ended 31 December 2016

	Note	2016 € m	2015 € m
Interest income and similar income	3	205	231
Interest expense and similar charges	4	(35)	(69)
<b>Net interest income</b>		<b>170</b>	<b>162</b>
Net trading gain	5	3	3
Other operating expense	6	(10)	(9)
<b>Total operating income</b>		<b>163</b>	<b>156</b>
Administrative expenses	7	(5)	(44)
<b>Operating profit before provisions</b>		<b>158</b>	<b>112</b>
(Provisions)/ Writeback for impairment of loans and receivables	8	(20)	10
<b>Operating profit before taxation</b>		<b>138</b>	<b>122</b>
Income tax charge	9	(17)	(15)
<b>Profit for the financial year</b>		<b>121</b>	<b>107</b>

The operating profit arises from continuing operations.

## STATEMENT OF COMPREHENSIVE INCOME

For the financial year ended 31 December 2016

	2016 € m	2015 € m
Profit for the financial year	121	107
Other comprehensive income for the financial year	-	-
<b>Total comprehensive income for the financial year</b>	<b>121</b>	<b>107</b>

The notes on pages 53 to 85 are an integral part of these financial statements.

## STATEMENT OF FINANCIAL POSITION

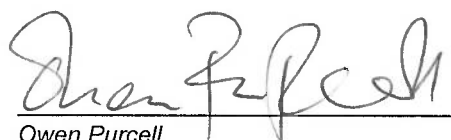
As at 31 December 2016

	Note	2016 € m	2015 € m
<b>Assets</b>			
Non-current asset held for sale	10	2	2
Derivative financial instruments	11	19	20
Loans and receivables to banks	12	49	60
Loans and receivables to customers	13	4,880	5,265
Current taxation	9	3	-
<b>Total assets</b>		<b>4,953</b>	<b>5,347</b>
<b>Liabilities</b>			
Deposits by banks	15	2,674	2,271
Derivative financial instruments	11	18	20
Debt securities in issue	16	1,500	2,387
Current taxation	9	-	7
Accruals and deferred income		-	1
Provisions for liabilities and commitments	17	14	35
<b>Total liabilities</b>		<b>4,206</b>	<b>4,721</b>
<b>Shareholders' equity</b>			
Issued share capital presented as equity	18	552	552
Revenue reserves		195	74
<b>Shareholders' equity</b>		<b>747</b>	<b>626</b>
<b>Total liabilities and shareholders' equity</b>		<b>4,953</b>	<b>5,347</b>

The notes on pages 53 to 85 are an integral part of these financial statements.



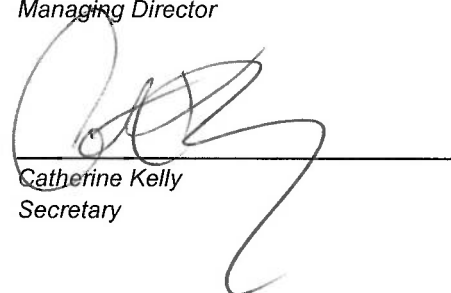
Denis Holland  
Chairman



Owen Purcell  
Managing Director



Gerry Gaffney  
Executive Director



Catherine Kelly  
Secretary

Date: 30 March 2017

## STATEMENT OF CASH FLOWS

For the financial year ended 31 December 2016

	Note	2016 € m	2015 € m
<b>Cash flows from operating activities</b>			
Operating profit before taxation		138	122
Amortisation of Fair Value discount on debt securities in issue	4	9	30
Writeback for impairment on loans and receivables	8	20	(10)
Fair value movement on trading item		(1)	-
		166	142
<b>Changes in operating assets and liabilities</b>			
Change in loans and receivables to customers		365	367
Change in accrual and deferred income		(1)	1
Change in provision for liability and commitments		(21)	35
Change in other assets		-	(2)
Change in other liabilities		1	2
<b>Net cash flows from operations before taxation</b>		510	545
Taxation paid		(28)	-
<b>Net cash flows from operations</b>		482	545
<b>Net cash flow from investing activities</b>		-	-
<b>Cash flow from financing activities</b>			
Loss on repurchase of debt securities in issue		10	9
(Redemption)/ issue of debt securities		(906)	541
Change in deposits by banks		403	(1,112)
<b>Net cash flows from financing activities</b>		(493)	(562)
<b>Net decrease in cash and cash equivalents</b>		(11)	(17)
Cash and cash equivalents at 1 January		60	77
<b>Cash and cash equivalents at 31 December</b>	20	49	60

The notes on pages 53 to 85 are an integral part of these financial statements.

## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the financial year ended 31 December 2016

	Ordinary Share Capital € m	Revenue Reserves € m	Total Shareholders' Equity € m
At 1 January 2016	552	74	626
Total comprehensive income for the financial year	-	121	121
At 31 December 2016	552	195	747
At 1 January 2015	552	(33)	519
Total comprehensive income for the financial year	-	107	107
At 31 December 2015	552	74	626

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- 1.3 Basis of preparation
- 1.4 Interest income and expense recognition
- 1.5 Net trading income
- 1.6 Financial assets
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- 1.8 Derivatives and hedge accounting
- 1.9 Impairment of financial assets
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- 1.17 Prospective accounting changes

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES**

The accounting policies applied in the preparation of the financial statements for the financial year ended 31 December 2016 are set out below.

**1.1. Reporting entity**

EBS Mortgage Finance (the 'Bank') is a public unlimited company and commenced trading on 1 December 2008 operating under the Irish Central Bank Act, 1971 (as amended) and is a designated mortgage credit institution under the Asset Covered Securities Acts 2001 and 2007. The Bank is a wholly owned subsidiary of EBS d.a.c., which is included as part of EBS (the 'Group') and AIB Group ("AIB Group") and is regulated by the SSM.

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 financial year ended 31 December 2016. The accounting policies have been consistently applied by the Bank and are consistent with the previous year, unless otherwise described. The financial statements also comply with the Companies Act 2014 applicable to companies reporting under IFRS and the European Communities (Credit Institutions: Financial Statements) Regulations, 2015 (as amended) and the Asset Covered Securities Acts 2001 and 2007 and the listing rules of the ISE.

**1.3. Basis of preparation*****Functional and presentation currency***

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

***Basis of measurement***

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

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

***Use of estimates and judgements***

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of certain assets, liabilities, revenues, expenses and disclosures of contingent assets and liabilities. The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Since management's judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The estimates that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of loan impairment and impairment of other financial instruments; determination of the fair value of certain financial assets and liabilities and provisions for liabilities and commitments. In addition, the designation of financial assets and financial liabilities has a significant impact on their income statement treatment and could have a significant impact on reported income. A description of these estimates and judgements is set out in note 2 of the financial statements.

***Going concern***

The financial statements for the financial year ended 31 December 2016 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.



**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.3. Basis of preparation (continued)*****Going concern (continued)***

EBS Mortgage Finance is dependent on its ultimate parent, Allied Irish Banks, p.l.c. for continued funding and is therefore dependent on the going concern status of the ultimate parent.

The financial statements of Allied Irish Banks, p.l.c. for the financial year ended 31 December 2016 have been prepared on a going concern basis as the Directors of AIB Group are satisfied, having considered the risks and uncertainties impacting the AIB Group, that it has the ability to continue in business for the period of assessment. The period of assessment used by the Directors of AIB Group is twelve months from the date of approval of its annual financial statements.

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 2017 to 2019 approved by the Board in December 2016, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios. In formulating these plans, the current Irish economic environment and forecasts for growth and employment were considered as well as the stabilisation of property prices. The Directors of AIB Group have also considered the outlook for the Eurozone and UK economies, and the factors and uncertainties impacting their performance including the possible fallout from Brexit.

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

The Directors of AIB Group 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 in the market place, that in all reasonable circumstances required liquidity and funding from the CBI/ECB would be available to the Group during the period of assessment.

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 Groups ability to continue as a going concern over the period of assessment.

***Conclusion***

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

***Adoption of new accounting standards***

During the year to 31 December 2016, the Group adopted amendments to standards and interpretations which had an insignificant impact on these financial statements.

**1.4. Interest income and expense recognition**

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

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

In calculating the effective interest rate, the Bank estimates cash flows (using projections based on its experience of customers' behaviour) considering all contractual terms of the financial instrument but excluding future credit losses. The calculation takes into account all fees, including those for any expected early redemption, and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts.

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.4. Interest income and expense recognition (continued)**

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;
- Net interest income and expense on qualifying hedge derivatives designated as cash flow hedges or fair value hedges which are recognised in interest income or interest expense.

**1.5. Net trading income**

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

**1.6. Financial assets*****Loans and receivables***

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale. They arise when EBSMF acquires loans or receivables with no intention of trading the loan. Loans and receivables are initially recognised at fair value adjusted for direct and incremental transaction costs and are subsequently carried on an amortised cost basis. See note 1.14 for detailed disclosure of the valuation techniques used.

**1.7. Financial liabilities**

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

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

The Bank derecognises a financial liability when its contractual obligation is discharged, cancelled or expired. Any gain or loss on the extinguishment or re-measurement of a financial liability is recognised in the income statement. See note 1.14 for detailed disclosure of the valuation techniques used.

**1.8. Derivatives and hedge accounting**

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

***Derivatives***

Derivatives are measured initially at fair value on the date on which the derivative contract is entered into and subsequently remeasured at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and from valuation techniques using discounted cash flow models and option pricing models as appropriate. Derivatives are included in assets when their fair value is positive and in liabilities when their fair value is negative, unless there is the legal ability and intention to settle an asset and liability on a net basis.

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

Profits or losses are only recognised on initial recognition of derivatives when there are observable current market transactions or valuation techniques that are based on observable market inputs.

***Hedging***

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

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

The Bank discontinues hedge accounting when:

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.8. Derivatives and hedge accounting (continued)*****Hedging (continued)***

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

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

***Fair value hedge accounting***

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

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

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

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

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

See note 1.14 for detailed disclosure of the valuation techniques used.

**1.9. Impairment of financial assets**

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

***Impairment***

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

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

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.9. Impairment of financial assets (continued)*****Incurred but not reported***

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (i.e. individually insignificant). If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and includes these performing assets under the collective incurred but not reported ('IBNR') assessment.

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

***Collective evaluation of impairment***

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

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and the historical loss experience for assets with credit risk characteristics similar to those in 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 assumption used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

***Impairment loss***

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

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

When a loan has been subjected to a specific provision and the prospects of recovery do not improve, a time will come when it may be concluded that there is no real prospect of recovery. When this point is reached, the amount of the loan which is considered to be beyond the prospect of recovery is written off against the related provision for loan impairment. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

***Collateralised financial assets – Repossessions***

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, costs for obtaining and settling the collateral, and whether or not foreclosure is probable. For loans which are impaired, the Group may repossess collateral previously pledged as security in order to achieve an orderly realisation of the loan. The Group 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.

***Past due loans***

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

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

***Loans renegotiated and forbearance***

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.9. Impairment of financial assets (continued)*****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. These are detailed under Credit Risk at section 3.1 of Risk Management Report. A request for a forbearance solution acts as a trigger for an impairment test.

All loans that are assessed for a forbearance solution are tested for impairment under IAS 39 and where a loan is deemed impaired, an appropriate provision is raised to cover the difference between the loan's carrying value and the present value of estimated future cash flows discounted at the loan's original effective interest rate. Where, having assessed the loan for impairment and the loan is not deemed to be impaired, it is included within the collective assessment as part of the IBNR provision calculation.

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

Where a loan has been subject to an impairment provision and the renegotiation leads to a customer granting equity to the Group in exchange for any loan balance outstanding, the new instrument is recognised at fair value with any difference to the loan carrying amount recognised in the income statement.

***Non-forbearance renegotiation***

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

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

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

**1.10. Non-credit risk provisions**

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

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

**1.11. Income tax, including deferred tax**

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

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.11. Income tax, including deferred tax (continued)**

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 the asset to be recovered.

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

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

**1.12. Cash and cash equivalents**

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

**1.13. Shareholder's Equity**

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

**Share capital**

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

**Dividends and distributions**

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

**Revenue reserves**

Revenue reserves represent retained earnings of the Bank.

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

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The Group 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 Group 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.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.14 Determination of fair value of financial instruments (continued)**

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

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

Where securities are traded on an exchange, the fair value is based on prices from the exchange. The market for debt securities largely operates on an 'over the counter' basis which means that there is not an official clearing or exchange price for these security instruments.

Therefore, market makers and/or investment banks ('contributors') publish bid and offer levels which reflect an indicative price that they are prepared to buy and sell a particular security. The Group's valuation policy requires that the prices used in determining the fair value of securities quoted in active markets must be sourced from established market makers and/or investment banks.

**Valuation techniques**

In the absence of quoted market prices, and in the case of over-the-counter derivatives, fair value is calculated using valuation techniques. Fair value may be estimated using quoted market prices for similar instruments, adjusted for differences between the quoted instrument and the instrument being valued. Where the fair value is calculated using discounted cash flow analysis, the methodology is to use, to the extent possible, market data that is either directly observable or is implied from instrument prices, such as interest rate yield curves, equity and commodity prices, credit spreads, option volatilities and currency rates. In addition, the Group 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 at which an orderly transaction between market participants would occur under current market conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments will be based on some market observable inputs even where the non-observable inputs are significant. All unobservable inputs used in valuation techniques reflect the assumptions market participants would use when fair valuing the financial instrument.

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

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

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

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



**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.15. Non-current asset held for sale**

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

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

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

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

Assets held for sale are presented separately on the statement of financial position. Prior periods are not reclassified.

**1.16. Foreign currency translation**

Items included in the financial statements of EBSMF are measured using their functional currency, being the currency of the primary economic environment in which the entity operates.

**Transactions and balances**

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

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

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

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

A Group-wide project has been rolled out where the various types of revenue streams have been identified and analysed. However, due to the nature of these revenue streams, no significant change to the Bank's financial statements has been highlighted as a result of the analysis. Accordingly, it is expected that any impact will be minimal, although not yet quantified.

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

The impacts of this standard are being considered by the Bank.

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

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

IFRS 9 Financial Instruments was issued in July 2014 and will replace IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes a revised classification and measurement model, a forward looking 'expected credit loss' impairment methodology and modifies the approach to hedge accounting. Unless early adopted, the standard is effective for accounting periods beginning 1 January 2018. The key changes under the standard are:



**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.17. Prospective accounting changes (continued)****(b) IFRS 9 Financial Instruments (continued)**Classification and measurement

Financial assets are classified on the basis of the business model within which they are held and their contractual cashflow characteristics. The classification and measurement categories are amortised cost, fair value through other comprehensive income and fair value through profit and loss.

A financial asset is measured at amortised cost if two criteria are met: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest.

If a financial asset is eligible for amortised cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch.

Interest is calculated on the gross carrying amount of a financial assets, except where the asset is credit impaired in which case interest is calculated on the carrying amount after deducting the impairment provision.

There is no separation of an embedded derivative where the instrument is a financial asset.

Equity instruments must be measured at fair value, however, an entity can elect on initial recognition to present fair value changes, including any related foreign exchange component on non-trading equity investments directly in other comprehensive income. There is no subsequent recycling of fair value gains and losses to profit or loss; however dividends from such investments will continue to be recognised in profit or loss.

Impairment

Requires more timely recognition of expected credit losses using a three stage approach. For financial assets where there has been no significant increase in credit risk since origination, a provision for 12 months expected credit losses is required. For financial assets where there has been a significant increase in credit risk or where the asset is credit impaired, a provision for full lifetime expected losses is required.

The assessment of whether credit risk has increased significantly since origination is performed for each reporting period by considering the change in risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in expected credit loss.

The assessment of credit risk, and the estimation of expected credit loss, are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of expected credit loss should take into account the time value of money. As a result, the recognition and measurement of impairment is more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month expected credit loss and the population of financial assets to which lifetime expected credit loss applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

Financial liabilities

The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income.

Hedge accounting

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

Assessment of IFRS 9 Impacts

An AIB Group-wide Programme, led jointly by Risk and Finance, commenced work during 2015 to oversee delivery of the requirements for implementation of IFRS 9.

The governance structure includes a Steering Committee mandated to oversee implementation in accordance with the standard, a Technical Approval Group to approve key accounting policy change decisions and an Operating Model Design Authority to approve operating model specifications.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.17. Prospective accounting changes (continued)

*(b) IFRS 9 Financial Instruments (continued)***Assessment of IFRS 9 Impacts (continued)**

Detailed planning was completed during 2015 and the Design Phase commenced thereafter, with a number of key decisions required over the course of the first few months in 2016. The Programme is structured with various work streams responsible for designing and implementing the end state target operating model, technical accounting interpretations, building and validating IFRS 9 provision models and assessing data and systems requirements.

**Classification and measurement**

Classification and measurement of financial assets is not expected to result in any significant changes for the EBSMF.

In general:

- loans and receivables to banks and customers that are currently classified as 'loans and receivables' under IAS 39 will be measured at amortised cost under IFRS 9;
- debt securities classified as available for sale under IAS39 will be measured at FVOCI;
- debt securities classified as held to maturity under IAS39 will be measured at amortised cost;
- all equity securities will continue to be measured at fair value, however, for individual securities, it has yet to be decided if the fair value movements will be presented in profit and loss or in other comprehensive income.

The business model assessment which has been carried out on the portfolio at 31 December 2015 is not expected to change the current measurement basis from EBSMF.

In relation to SPPI testing which is being carried out on the financial instruments portfolio, it is expected that a small number of instruments, mainly loans and receivables to customers, will fail the SPPI (solely payments of principal and interest) test. Accordingly, such instruments will be measured at fair value through profit or loss in accordance with IFRS 9. Fair value movements on these instruments will be shown in profit and loss. The impact on transition to the new measurement basis is not expected to be significant.

The classification of financial liabilities is largely unchanged under IFRS 9. Given that the Group does not fair value its own debt, there is no impact as a result of changes required under IFRS 9.

**Impairment**

To date the IFRS 9 Programme has focused on designing and documenting accounting policy changes, identifying and remediating data gaps, developing risk modelling options and methodologies for the calculation of the impairment allowance. The Programme's focus is now on building impairment models, validating outputs, testing policy proposals and processes which are being developed, and setting up processes for 'business as usual' under the new standard.

The impairment models will impact on IT, risk management and financial reporting systems. Significant progress has been made in ensuring business readiness for all such systems.

Due to the complexity of decisions required around several aspects of the impairment requirements of IFRS 9, and the interdependencies of variables within the models and the dynamic nature of some of those variables, it is considered premature at this stage to quantify the impacts of impairment under IFRS 9 with any degree of accuracy. However, it is expected that this information will be available in the 2017 Annual Financial Report.

**Hedge accounting**

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

**Initial application/disclosures/other**

The Group will apply the various provisions of IFRS 9 with effect from 1 January 2018, however, prior periods will not be restated. Any difference between the previous carrying amount under IAS 39 and the carrying amount at the date of initial application of IFRS 9 on 1 January 2018, will be recognised in opening retained earnings (or other component of equity as appropriate) at 1 January 2018.

A significant suite of reporting requirements are being developed for statutory, regulatory and management reporting in line with the requirements of IFRS 9 and the various regulatory bodies. In so far as possible, definitions of data items within reports are being aligned so as to assist comparability.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.17. Prospective accounting changes (continued)

*(b) IFRS 9 Financial Instruments (continued)***Assessment of IFRS 9 Impacts (continued)**

Furthermore, briefings to the business and various stakeholders throughout the Group have taken place and will continue throughout 2017 on the impacts of IFRS 9 and its consequences for the Group.

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

**(c) Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses**

The amendments in *Recognition of Deferred Tax Assets for Unrealised Losses*, which were issued in January 2016, clarify the following aspects:

- Unrealised losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use;
- The carrying amount of an asset does not limit the estimation of probable future taxable profits;
- Estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences; and
- An entity assesses a deferred tax asset in combination with other deferred tax assets. Where tax law restricts the utilisation of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

These amendments are not expected to have a significant impact on the Bank.

The amendments are subject to EU endorsement.

Effective Date: Annual periods beginning on or after 1 January 2017

**(d) Annual improvements to IFRSs 2014–2016 cycle/Other***Nature of Change*

The IASB has published a number of minor amendments to IFRSs through both standalone amendments and through the Annual Improvements to IFRS Standards 2014-2016 cycle. Whilst these have not yet been endorsed by the EU, they are expected to be effective from 1 January 2018 apart from the amendment to IFRS 12 'Disclosure of Interests in Other Entities' which is effective from 1 January 2017. These amendments are expected to have an insignificant effect on the financial statements.

**(e) Amendments to IAS 7 – Statement of Cash Flows**

The amendments to IAS 7 *Statement of Cash Flows*, which were issued in January 2016, require that the following changes in liabilities arising from financing activities be disclosed to the extent necessary:

- Changes from financing cash flows;
- Changes arising from obtaining or losing control of subsidiaries or other businesses;
- The effect of changes in foreign exchange rates;
- Other changes

It also stresses that the new disclosure requirements also relate to changes in financial assets if they meet the definition. These amendments are not expected to have a significant impact on the Bank.

The amendments are subject to EU endorsement.

Effective Date: Annual periods beginning on or after 1 January 2017.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES**

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of certain assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Since management judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates.

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

**(a) Going concern**

The financial statements for the financial year ended 31 December 2016 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.

EBS Mortgage Finance is dependent on its ultimate parent, Allied Irish Banks, p.l.c. for continued funding and is therefore dependent on the going concern status of the ultimate parent.

As such, the financial statements of Allied Irish Banks, p.l.c for the financial year ended 31 December 2016 have been prepared on a going concern basis as the Directors of AIB Group are satisfied, having considered the risks and uncertainties impacting the AIB Group, that it has the ability to continue in business for the period of assessment.

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 2017 to 2019 approved by the AIB Group Board in December 2016, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios. In formulating these plans, the current Irish economic environment and forecasts for growth and employment were considered as well as the stabilisation of property prices. The Directors of AIB Group have also considered the outlook for the Eurozone and UK economies, and the factors and uncertainties impacting their performance including the possible fallout from Brexit.

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

**(b) Loan impairment**

The Bank's accounting policy for impairment of financial assets is set out in accounting policy number 1.9. The provisions for impairment on loans and receivables at 31 December 2016 represent management's best estimate of the losses incurred in the loan portfolios at the reporting date. The estimation of loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local economic climate, conditions in various industries to which the borrowers are exposed, and other external factors such as legal and regulatory requirements.

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

**Specific provision**

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

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

**Incurred but not reported provisions**

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

The total amount of impairment loss in the Bank's non-impaired portfolio, and therefore the adequacy of the IBNR provision is inherently uncertain. 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 Group operates. For further details please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on page 16 of the Risk management section of this report.

**Forbearance**

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

**(c) Fair value of financial instruments**

The best evidence of fair value is quoted prices in an active market. The absence of quoted prices increases reliance on valuation techniques and requires the use of judgement in the estimation of fair value. This judgement includes but is not limited to: evaluating available market information; determining the cash flows for the instruments; identifying a risk free discount rate; and applying an appropriate credit spread. Valuation techniques that rely to a greater extent on non-observable data require a higher level of management judgement to calculate a fair value than those based wholly on observable data.

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

**d) Provisions for liabilities and commitments**

EBSMF's accounting policy for provisions for liabilities and commitments is set out in accounting policy number 1.10 'Non-credit risk provisions' in Note 1.

EBSMF recognises provisions where it has present legal or constructive obligations as a result of past events and it is more likely than not that these obligations will result in an outflow of resources to settle the obligations and the amount can be reliably estimated. Details of the Bank's provisions for liabilities and commitments are shown in Note 17 to the financial statements.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

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

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

At 31 December 2015, EBS Group provided €35 million for redress to customers. This provision related to the expected outflow for compensation/refunds of interest to customers in respect of tracker mortgages where rates given to customers were either not in accordance with original contract terms or where the transparency of terms did not conform to that which a customer could reasonably expect. The provision covered various compensations and costs arising from this issue.

Considerable progress was made throughout 2016 in identifying impacted customers and in calculating and making redress. However, this process is on-going and work is expected to extend into the second six months of 2017. To date €6 million of the provision has been utilised covering both redress and costs and €15 million has been transferred out leaving a residual provision of €14 million at 31 December 2016.

Validation of the final number of impacted accounts is subject to independent third party assurance and also subject to assessment and challenge by the CBI.

Given the uncertainty attaching to certain of the assumptions and judgements underpinning the above provisions, it is possible that the eventual outcome may differ from the current estimates with a resultant charge/credit to the income statement in future periods.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 3. INTEREST INCOME AND SIMILAR INCOME

	2016 € m	2015 € m
Interest on loans and receivables to customers	162	187
Amortisation of fair value discount on loans and receivables to customers	43	44
	205	231

Included within various captions under interest income for the financial year ended 31 December 2016 is a total of €16m (2015: €29m) accrued on impaired financial assets.

## 4. INTEREST EXPENSE AND SIMILAR CHARGES

	2016 € m	2015 € m
Interest payable to credit institutions	16	21
Interest on debt securities in issue	10	18
Amortisation of fair value discount on debt securities in issue	9	30
	35	69

## 5. NET TRADING INCOME

	2016 € m	2015 € m
Debt Securities and interest rate contracts	3	3
	3	3

## 6. OTHER OPERATING EXPENSE

	2016 € m	2015 € m
Loss on repurchase of debt securities in issue	10	9
	10	9

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 7. ADMINISTRATIVE EXPENSES

	2016 € m	2015 € m
Personnel expenses	-	-
Other administrative expenses	(11)	39
Amounts payable to EBS	16	5
	5	44

Other administrative expenses includes a credit for provision for liabilities and commitments transferred out of €15m (2015: charge of €35m) that relates to provisions for customer redress (see note 2 critical accounting judgements and estimates: (d) provisions for liabilities and commitments), professional fees €0.6m (2015: €0.5m) and statutory payments (regulatory payments/ levies) €3.5m (2015: €2.1m).

There are no full time equivalents employed by EBS Mortgage Finance in the financial year 2016 (2015: Nil).

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

*Auditors' remuneration (excluding VAT)*

	2016 € '000	2015 € '000
Statutory Audit of entity financial statements	13	12
Other assurance services		-
Tax advisory services		-
Other non-audit services	10	-
<b>Total auditors' remuneration</b>	<b>23</b>	<b>12</b>

The disclosure of Auditors' fees are in accordance with section 322 of the Companies Act 2014 which mandates fees in particular categories and that fees paid to the EBS Mortgage Finance's Auditor (Deloitte) for services to the Bank only be disclosed in this format. Other assurance services include fees for additional assurance issued by the firm outside of the audit of the statutory financial statements. These fees include assignments where the auditor provides assurance to third parties.

The remuneration of the Non-Executive Directors in office during 2016 is as follows:

	2016 € '000	2015 € '000
Fees	30	30
	30	30

No additional remuneration has been made to any individuals employed directly by Allied Irish Banks, plc. for roles discharged as directors of EBS Mortgage Finance. The non-executive Director fees are non-pensionable.

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

There was no amounts paid (2015: nil) to persons connected with a director in accordance with Section 306(1) of the Companies Act 2014.



## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 8. IMPAIRMENT OF LOANS AND RECEIVABLES

	2016			2015		
	Specific € m	IBNR € m	Total € m	Specific € m	IBNR € m	Total € m
Balance at start of year	253	28	281	280	56	336
Charge/(release) against income statement	19	1	20	18	(28)	(10)
Amounts written off	(14)	-	(14)	(45)	-	(45)
<b>Balance at end of year</b>	<b>258</b>	<b>29</b>	<b>287</b>	<b>253</b>	<b>28</b>	<b>281</b>

By geographical location and industry sector	2016 € m	2015 € m
<i>Republic of Ireland</i>		
Home Mortgages	287	281

## 9. TAXATION

	2016 € m	2015 € m
Current tax charge on income for financial year	(17)	(7)
Tax losses utilised during the year (note 14)	-	(8)
<b>Total tax charge for the financial year</b>	<b>(17)</b>	<b>(15)</b>

The tax charge (2015: charge) for the financial year is at an effective rate of 12.5%, which is the same as the standard Irish corporation tax rate.

	2016 € m	%	2015 € m	%
Operating profit before taxation	138		122	
Corporation tax charge (12.5%)	(17)	12.5	(15)	12.5
Tax charge	(17)	12.5	(15)	12.5

## 10. NON-CURRENT ASSETS HELD FOR SALE

	2016 € m	2015 € m
Reposessed assets	2	2
	2	2

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 11. DERIVATIVE FINANCIAL INSTRUMENTS

Set out below are details on fair values and derivative information for EBS Mortgage Finance. The Bank uses interest rate swaps to hedge the interest rate risk. The first type is used to hedge interest rate risk on mortgage loan accounts both within the Cover Assets Pool and outside the Cover Assets Pool, effectively converting interest receivable from a fixed rate basis to a floating rate basis. Although these swaps are considered to be an effective hedge in economic terms, due to their nature, it has not been possible to establish a "Fair Value" hedging relationship under IAS 39 with the mortgage loan accounts and consequently, they are classified as "Held for Trading".

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

	Contract/ Notional Amount € m	2016		Contract/ Notional Amount € m	2015	
		Fair Asset € m	Fair Liability €m		Fair Asset € m	Fair Value Liability €m
<b>Derivatives classified as trading</b>						
Interest rate swaps	5,285	19	18	5,707	20	20
<b>Total derivatives</b>	<b>5,285</b>	<b>19</b>	<b>18</b>	<b>5,707</b>	<b>20</b>	<b>20</b>

The following table represents the underlying principal and gross replacement costs of the Bank's derivatives as at 31 December 2016 and 31 December 2015.

	Residual Maturity 2016				Residual Maturity 2015			
	Within 1yr € m	1 to 5 yrs € m	Over 5 yrs € m	Total € m	Within 1 yr € m	1 to 5 yrs € m	Over 5 yrs € m	Total € m
<b>Underlying principal amount</b>								
Interest rate contracts	-	137	5,148	5,285	-	-	5,707	5,707
<b>Positive fair value</b>								
Interest rate contracts	-	2	17	19	-	-	20	20

## 12. LOANS AND RECEIVABLES TO BANKS

	2016 € m	2015 € m
<b>Funds placed with EBS d.a.c.</b>		
Analysed by remaining maturity:		
3 months or less	30	31
<b>Funds placed with other banks outside AIB</b>		
Analysed by remaining maturity:		
3 months or less	19	29
	<b>49</b>	<b>60</b>

For the purpose of cash flows the cash and cash equivalents comprise the above. Loans and receivable to banks include balances with original maturities of less than 3 months. The balances held with other banks outside AIB Group represent Cash Substitution Pool Assets. Cash substitution pool assets are an Asset Covered Securities Act concept whereby certain assets can be held as part of the Cover Assets Pool. At 31<sup>st</sup> December 2016, BNP bank credit rating with Standard & Poor's was A, KBC bank credit rating was A and BNY Mellon's credit rating was AA-.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 13. LOANS AND RECEIVABLES TO CUSTOMERS

	2016 € m	2015 € m
Analysed by remaining maturity:		
Repayable on demand	709	960
3 months or less	-	1
1 year or less but over 3 months	2	3
5 years or less but over 1 year	87	92
Greater than 5 years	4,369	4,490
	5,167	5,546
Impairment of loans and receivables (Note 8)	(287)	(281)
	4,880	5,265

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

Loans and receivables to customers comprise EBS d.a.c. originated residential mortgages in the Republic of Ireland.

Interest recognised on impaired loans amounted to €16m (2015: €29m) and is included in the carrying value of loans and receivables to customers. This has been credited to interest income.

<i>By geographic location and sector</i>	2016 € m	2015 € m
<i>Republic of Ireland</i>		
Home mortgages (net of impairment)	4,880	5,265
	4,880	5,265

## 14. DEFERRED TAXATION

	2016 € m	2015 € m
At 1 January	-	9
Income statement	-	(8)
Adjustment in respect of prior year	-	(1)
At 31 December	-	-

At 31 December 2016, deferred tax assets on tax losses and other temporary differences, net of deferred tax liabilities, totalled Nil (2015: Nil). The tax losses arose in the Irish tax jurisdiction and their utilisation was dependent on the generation of future taxable profits.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 15. DEPOSITS BY BANKS

	2016	2015
	€ m	€ m
Funds received from EBS d.a.c.	2,674	2,271
	2,674	2,271

The facility limit with EBS is €6.0bn and the balance at 31 December 2016 amounted to €2.7bn (2015: €2.3bn). 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.

## 16. DEBT SECURITIES IN ISSUE

	2016	2015
	€ m	€ m
<i>Mortgage covered securities in issue by remaining maturity:</i>		
3 months or less	-	425
1 year or less but over 3 months	-	666
5 years or less but over 1 year	500	796
Greater than 5 years	1,000	500
Carrying value of Debt Securities	1,500	2,387
<i>Mortgage covered securities to internal issuances at nominal value:</i>		
EBS d.a.c.	1,500	2,400
	1,500	2,400

EBS Mortgage Finance is an issuer of mortgage covered securities under the Asset Covered Securities Act 2001, as amended by the Asset Covered Securities Amendment Act, 2007 (the "Act"). The Act requires that mortgage covered securities are secured by assets that are included in a Cover Assets Pool maintained by the issuer and that a register of mortgage covered securities business is kept.

At 31 December 2016, the Cover Assets Pool amounted to €3.88bn (2015: €4.27bn), comprising of €3.86bn (2015: €4.24bn) of mortgage credit assets (mortgage loan accounts) and €0.02bn (2015: €0.03bn) of substitution assets (cash on deposit with suitably rated credit institutions). Section 40 (2) of the Act requires that the following information be disclosed in respect of mortgage credit assets that are recorded in the register of mortgage covered securities business.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 16. DEBT SECURITIES IN ISSUE (continued)

## (a) Mortgaged properties and principal loan balances outstanding in the Cover Assets Pool

## Total Loan Balances

		Total Loan Balances	Number of Mortgaged Properties	Total Loan Balances	Number of Mortgaged Properties
		2016	2016	2015	2015
		(1 & 2)	(1 & 2)	(1 & 2)	(1 & 2)
From	To	€ m		€ m	
€0	€100,000	513	11,046	540	11,650
€100,000	€200,000	1,634	10,952	1,702	11,369
€200,000	€500,000	1,618	6,280	1,879	7,240
Over €500,000		97	144	122	173
		3,862	28,422	4,243	30,432

(1) The total loan balances are categorised by the total loan balance outstanding per mortgaged property, including principal and interest charged to the loan accounts, but excluding interest accrued but not charged to the loan accounts.

(2) There could be one or more loan accounts per mortgaged property. The Cover Assets Pool contains 36,351 loan accounts (2015: 39,310) secured on 28,422 properties (2015: 30,432).

## (b) Geographical location of mortgaged properties in the Cover Assets Pool

Geographical Area	Number of Mortgaged Properties		Number of Mortgaged Properties	
	2016		2015	
Co. Dublin	9,966	35%	10,801	35%
Outside Dublin	18,456	65%	19,631	65%
	28,422	100%	30,432	100%

## (c) Mortgage loan accounts in default in the Cover Assets Pool with arrears greater than or equal to three months

As at 31 December 2016, there were 38 mortgage loan accounts (2015: 104) in default in the Cover Assets Pool (in default being defined as impaired mortgage loan accounts with arrears greater than or equal to 3 months).

## (d) Mortgage loan accounts in default in the Cover Assets Pool with arrears greater than €1,000

During the year ended 31 December 2016, 1,299 mortgage loan accounts (2015: 2,081) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2016, there were 278 accounts in default in the Cover Assets Pool (2015: 432).

## (e) Replacement of non-performing mortgage loan accounts from the Cover Assets Pool

During the year ended 31 December 2016, 176 non-performing mortgage loan accounts (2015: 340) were removed in total from the Cover Assets 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 in 2016 as the Cover Assets Pool continued to meet all regulatory requirements.

## (f) Amount of interest in arrears on mortgage loan accounts in the Cover Assets Pool not written off

The total amount of interest in arrears in respect of 894 accounts (2015: 1,224) as at 31 December 2016 was €0.4m (2015: €0.7m).

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

The total amount of repayments (principal and interest) made by customers on mortgage loan accounts in the Cover Assets Pool during the year ended 31 December 2016 was €459m (2015: €485m), of which €336m (2015: €336m) represented repayment of principal and €123m (2015: €148m) represented payment of interest. The repayments of principal include the repayment of mortgage loan accounts by customers closing their existing accounts.

## (h) Number and amount of mortgage loans in the Cover Assets Pool secured on commercial property

As at 31 December 2016 there were no loan accounts (2015: Nil) in the Cover Assets Pool that were secured on commercial properties.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 17. PROVISIONS FOR LIABILITIES AND COMMITMENTS

	2016	2015
	€m	€m
<b>Provisions</b>		
At 1 January	35	-
Amounts charged to income statement	-	35
Transfer out	(15)	-
Amounts written back	-	-
Provisions utilised	(6)	-
At 31 December <sup>(1)</sup>	14	35

**Provisions for customer redress**

In December 2015, the Central Bank of Ireland ("CBI"), requested the Irish banking industry, including EBSMF, to conduct a broad examination of tracker mortgage related issues, comprising of a review of mortgage loan books (including both PDH and Buy-to-let properties and loans that have been redeemed and/or sold), to assess compliance with both contractual and regulatory requirements. In situations where customer detriment is identified from this examination, AIB is required to provide appropriate redress and compensation in line with the CBI 'Principles for Redress'.

At 31 December 2015, the Bank had provided €35 million where either the interest rates were not in accordance with the relevant contractual documentation or where the Group would offer revised terms on mortgage accounts. This mainly related to the refund of interest (i.e. the difference in interest charged to customers compared to the interest that would have been charged when the tracker rate is applied). This provision also included amounts for compensating customers, such as reimbursement for the time value of money and other compensation amounts.

Considerable progress was made throughout 2016 in identifying impacted customers and in calculating and making redress. However, this process is on-going and work is expected to extend into the second six months of 2017. To date, €6 million of the provision has been utilised covering both redress and costs and €15 million has been transferred out leaving a residual provision of €14 million at 31 December 2016.

Given that the grounds on which the provisions have been estimated could prejudice the position of the Bank, further information as required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is not disclosed.

<sup>(1)</sup> The total provisions for liabilities and commitments expected to be settled within one year amount to €14 million (2015: €35m)

## 18. ISSUED SHARE CAPITAL PRESENTED AS EQUITY

	2016	2015
	€ m	€ m
Authorised:		
1,000,000,000 ordinary shares of €1.00 each	1,000	1,000
(2015: 1,000,000,000 ordinary shares of €1.00 each)	1,000	1,000
Issued and fully paid up:		
551,540,000 ordinary shares of €1.00 each	552	552
(2015: 551,540,000 ordinary shares of €1.00 each)	552	552

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.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 19. CAPITAL MANAGEMENT

## Capital regulation

CRD IV consists of the Capital Requirements Regulation ("CRR") and the Capital Requirements Directive ("CRD"), and is designed to strengthen the regulation of the banking sector and to implement the Basel III agreement in the EU legal framework. CRD IV measures include:

- a single set of harmonised prudential rules which enhanced requirements for quality and quantity of capital; and
- CRD IV also harmonises the deductions from own funds in order to determine the amount of regulatory capital that is prudent to recognise for regulatory purposes. Some of the provisions of CRD IV were introduced on a phased basis from 2014, these typically followed 20% in 2014, 40% in 2015 etc. until 2018.

AIB Group commenced reporting to its regulator under the transitional CRD IV rules during 2014. The transitional capital ratios presented on page 6 take account of these phasing arrangements. The fully loaded capital ratios represent the full implementation of CRD IV.

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

The CET1 transitional ratio is significantly in excess of the SSM's minimum CET1 regulatory requirement (see page 6).

At all times during 2016, capital held exceeded the regulatory capital requirements.

## 20. STATEMENT OF CASH FLOWS

## Analysis of Cash and Cash Equivalents

	2016 € m	2015 € m
Loans and receivables to banks (note 12)	49	60
	49	60

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

## 21. SEGMENTAL INFORMATION

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

## 22. 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 1.14.

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, shareholders' equity and assets held for sale. 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 2016.

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

## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

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

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

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

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

All financial instruments are initially recognised at fair value. Financial instruments held for trading and financial instruments in fair value hedge relationships are subsequently measured at fair value through profit or loss. 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 AIB Group and valuation methodologies are validated by the Risk function within AIB Group.

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

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

***Derivative financial instruments***

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

***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 banks***

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

***Loans and receivables to customers***

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

In addition to the assumptions set out above under valuation techniques regarding cash flows and discount rates, a key assumption for loans and receivables is that the carrying amount of variable rate loans (excluding mortgage products) approximates to market value where there is no significant credit risk of the borrower. The fair value of variable rate mortgage products including tracker mortgages is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in the portfolio. For fixed rate loans, the fair value is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in that portfolio. For the overall loan portfolio, an adjustment is made for credit risk which at 31 December 2016 took account of the Banks' expectations on credit losses over the life of the loans.

***Deposits by banks***

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

***Debt securities in issue***

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

***Other financial assets and other financial liabilities***

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



## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

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

		Carrying amount in statement of financial position				Fair Value hierarchy					2016
		At fair value through profit and loss	At fair value through equity	At amortised cost		Total					
		Fair value hedge derivative	Cash flow hedge derivatives	Loans and receivables	Other		Level 1	Level 2	Level 3	Total	
		€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Financial assets measured at fair value											
Derivative financial instruments											
Interest Rate Derivatives		19	-	-	-	19	-	19	-	-	19
Financial assets not measured at fair value											
Loans and receivables to banks		-	-	49	-	49	-	-	-	49	49
Loans and receivables to customers		-	-	4,880	-	4,880	-	-	-	4,696	4,696
		19	-	4,929	-	4,948	-	19	4,745	4,764	
Financial liabilities measured at fair value											
Derivative financial instruments											
Interest Rate Derivatives		18	-	-	-	18	-	18	-	-	18
Financial liabilities not measured at fair value											
Deposits by banks		-	-	-	2,674	2,674	-	-	-	2,674	2,674
Debt securities in issue		-	-	-	1,500	1,500	-	1,423	-	-	1,423
		18	-	-	4,174	4,192	-	1,441	2,674	4,115	

## NOTES TO THE FINANCIAL STATEMENTS (continued)

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

The following table sets out the carrying value of financial instruments across the three levels of the fair value hierarchy at the 31 December 2015:

	Carrying amount in statement of financial position							Fair Value hierarchy				2015
	At fair value through profit and loss		At fair value through equity		At amortised cost			Total				
	Held for trading	Fair value hedge derivative	Cash flow hedge derivatives	Loans and receivables	Other			Level 1	Level 2	Level 3	Total	
	€ m	€ m	€ m	€ m	€ m			€ m	€ m	€ m	€ m	
Financial assets measured at fair value												
Derivative financial instruments	-	-	-	-	-	-	-	-	-	-	-	
Interest Rate Derivatives	20	-	-	-	-	20	-	-	20	-	20	
Financial assets not measured at fair value												
Loans and receivables to banks	-	-	-	60	-	60	-	-	-	60	60	
Loans and receivables to customers	-	-	-	5,265	-	5,265	-	-	-	4,999	4,999	
	20	-	-	5,325	-	5,345	-	20	5,059	5,079	5,079	
Financial liabilities measured at fair value												
Derivative financial instruments	-	-	-	-	-	-	-	-	-	-	-	
Interest Rate Derivatives	20	-	-	-	-	20	-	-	20	-	20	
Financial liabilities not measured at fair value												
Deposits by banks	-	-	-	-	2,271	2,271	-	-	-	2,271	2,271	
Debt securities in issue	-	-	-	-	2,387	2,387	-	2,123	-	-	2,123	
Other financial liabilities	-	-	-	-	1	1	-	-	-	1	1	
	20	-	-	-	4,659	4,679	-	2,143	2,272	2,272	4,415	

## NOTES TO THE FINANCIAL STATEMENTS (continued)

**23. RELATED PARTY TRANSACTIONS**

The immediate holding company and controlling party is EBS d.a.c., 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 the 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.

**a) Transactions with EBS d.a.c.**

The following amounts represent the transactions and outstanding balances with EBS d.a.c.:

- Loans from EBS at 31 December 2016 are €2,674m (2015: €2,271m).
- Deposits placed with EBS at 31 December 2016 are €30m (2015: €31m).
- The nominal value of debt securities in issue to EBS at 31 December 2016 are €1,500m (2015: €2,400m).

*Derivative financial instruments with EBS d.a.c.*

Interest rate swaps	2016 € m	2015 € m
Assets (Fair value)	19	20
Liabilities (Fair value)	18	20

At 31 December 2016, there were no derivative transactions between the Bank and the ultimate parent, Allied Irish Banks, p.l.c..

	2016 € m	2015 € m
<b>Income and expense included in the Income Statement from related parties:</b>		
Service fee	(16)	(5)
Interest expense on loans	(16)	(21)
Interest expense on debt securities	(19)	(48)
Net trading income	3	3
Loss on repurchase of debt securities in issue (see Note 6)	(10)	(9)

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.

**b) Compensation of key management personnel**

Compensation of Key Management Personnel, namely Executive and Non-Executive Directors and Senior Executive Officers, in office during the year is paid by AIB and allocated to EBSMF under the Outsourcing and Agency Agreement (see Note 7 – Administration Expenses).

**c) Transactions with key management personnel**

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

Details of transactions with Key management personnel, and connected parties where indicated, for the year ended 31 December 2016 are as follows:

**(i) Current Directors**

Directors in office as at 31 December 2016, being Denis Holland, William Cunningham, Gerry Gaffney and Owen Purcell had no facilities with EBS Mortgage Finance during 2016 (2015: nil).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 23. RELATED PARTY TRANSACTIONS (continued)

*Transactions with key management personnel (continued)**(ii) Former Directors who were in office during the year*

Ms. Clarke who resigned with effect on 30 September 2016 had no facilities with EBS Mortgage Finance (2015: nil).

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

Senior Executive Officers in office during the year had no facilities with EBS Mortgage Finance during 2016 (2015: nil).

*(iv) Connected persons*

There were no loans to connected persons of Directors in office as at 31 December 2016, as defined in Section 220 of the Companies Act 2014.

As at 31 December 2016, no Directors or Senior Executive Officers held guarantees with EBS Mortgage Finance.

**d) Funding support**

At 31 December 2016 the amount of ECB funding received through the ECB Monetary Policy Operation Sale and Repurchase Agreements was Nil (2015: Nil). Other funding supports from the CBI, which had been in operation at 31 December 2010, were not availed of by EBS from May 2011 onwards.

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

The Irish Government, as a result of both its investment in AIB's 2009 Preference shares and AIB's participation in Government guarantee schemes, became a related party of AIB in 2009. Following the various ordinary/CNV share issues to the National Pensions Reserve Fund Commission (NPRFC)<sup>(1)</sup> during 2010 and 2011, AIB is under the control of the Irish Government.

<sup>(1)</sup>Transferred to the Ireland Strategic Investment Fund ("ISIF") on 22 December 2014. Ownership of ISIF vests with the Minister for Finance and is administered and managed by the NTMA.

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

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

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

- The acquisition of shares in other institutions;
- Maintenance of solvency ratios and compliance with any liquidity and capital ratios that the Central Bank, following consultation with the Minister, may direct;
- The appointment of non-executive directors and board changes;
- The appointment of persons to attend meetings of various committees;
- Restructuring of executive management responsibilities, strengthening of management capacity and improvement of governance;
- Declaration and payment of dividends;
- Restrictions on various types of remuneration;
- Buy-backs or redemptions by 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.

In addition, various other initiatives such as strategies/codes of conduct for dealing with mortgage and other consumer/business loan arrears are set out in the Risk section of this report.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 23. RELATED PARTY TRANSACTIONS (continued)

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

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

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

In addition, the European Commission, in approving AIB's restructuring plan on 7 May 2014, found that restructuring aid granted by Ireland to AIB is in line with EU state aid rules

*- Guarantee schemes*

The European Communities (Deposit Guarantee Schemes) Regulations 1995 have been in operation since 1995. These regulations guarantee certain retail deposits up to a maximum of €100,000. In addition, since September 2008, the Irish Government has guaranteed relevant deposits and debt securities of AIB.

*- ELG Scheme*

In January 2010, Allied Irish Banks, p.l.c., and certain of its subsidiaries, became participating institutions for the purposes of the ELG Scheme (Eligible Liabilities Guarantee). This scheme expired on 28 March 2013 for all new liabilities. The total liabilities guaranteed under the ELG scheme at 31 December 2016 amounted to €1.1 billion (2015: €1.8 billion). Participating institutions must pay a fee to the Minister in respect of each liability guaranteed under the ELG Scheme. Participating institutions are also required to indemnify the Minister for any costs and expenses of the Minister and for any payments made by the Minister under the ELG Scheme which relate to the participating institutions guarantee under the ELG Scheme.

*- Funding support*

Throughout the financial crisis, the Irish Government provided guarantees to AIB Group and in this regard the ELG Scheme is outlined above. In addition, AIB Group has availed of Targeted Long Term Refinancing Operation II ("TLTRO II") funding from the ECB through the Central Bank. At 31 December 2016 the amounts outstanding totalled to € 1.9 billion (2015: € 2.9 billion for TLTRO). The interest rate on the TLTRO II is the main ECB rate which is currently 0%. The term of the TLTRO II is four years with AIB Group having the option to repay after two years.

*- PCAR/PLAR*

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

*- Credit Institutions (Stabilisation) Act 2010*

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

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

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)****23. RELATED PARTY TRANSACTIONS (continued)***- 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.

*- Relationship framework*

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

*- Approval of AIB Restructuring Plan*

On 7 May 2014, the European Commission approved, under state aid rules, AIB's Restructuring Plan. In arriving at its final decision, the European Commission acknowledged the significant number of restructuring measures already implemented by AIB, comprising business divestments, asset deleveraging, liability management exercises and significant cost reduction actions. The Commission concluded that the Restructuring Plan sets out the path to restoring long term viability. The plan covers the period from 2014 to 2017.

*- Restructuring Plan Commitments*

AIB has committed to a range of measures relating to customers in difficulty: cost caps and reductions; acquisitions and exposures; coupon payments; promoting competition; and the repayment of aid to the State. All of the commitments are aligned to AIB's operational plans and are supportive of AIB's return to viability.

**24. COMMITMENTS**

At 31 December 2016 the Bank had €10m (2015: €11m) of approved mortgage loan applications that had not been drawn down as at the financial year end.

**25. NON-ADJUSTING EVENTS AFTER REPORTING PERIOD**

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

**26. APPROVAL OF FINANCIAL STATEMENTS**

The financial statements were approved by the Board of Directors on the 30/03 2017.