EBS MORTGAGE FINANCE

Directors' Report and

Annual Financial Statements

For the financial year ended 31 December 2017

Contents

Directors and Other Information

DIRECTORS	Denis Holland	Independent Non-Executive Director and Chairman
	Chris Curley	Executive Director (Managing Director)
	Niamh Carolan	AIB Group Non-Executive Director
	William Cunningham	Independent Non-Executive Director
	Brendan McDonagh	Independent Non-Executive Director
	Jim O'Hara	Independent Non-Executive Director
	Gerry Gaffney	Executive Director

SECRETARY Cara Teahan

REGISTERED OFFICE
The EBS Building
2 Burlington Road
Dublin 4
Ireland

REGISTERED NUMBER 463791

REGISTERED AUDITOR
Deloitte
Chartered Accountants & Statutory Audit Firm
Deloitte & Touche House
Earlsfort Terrace
Dublin 2

BANKERS
EBS Designated Activity Company
2 Burlington Road
Dublin 4
Ireland

BNP Paribas Ireland
5 George's Dock
International Financial Services Centre
Dublin 1
Ireland

COVER-ASSETS MONITOR
Mazars
Harcourt Centre
Block 3
Harcourt Road
Dublin 2
Ireland

Directors' Report

The Directors of EBS Mortgage Finance (hereafter referred to as the "Bank") present their Directors' Report ("the Report") and audited financial statements for the financial year ended 31 December 2017. A Directors' Responsibility Statement in relation to the financial statements appears on page 48.

Principal activities

The Bank, a public unlimited company, obtained an Irish banking licence under the Irish Central Bank Act, 1971 (as amended) and was registered as a designated mortgage credit institution under the Asset Covered Securities Act, 2001 on 30 October 2008. The Bank has 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') and a member of EBS Group (the 'Group'). EBS is a wholly owned subsidiary of Allied Irish Banks, p.l.c. ('AIB') which is a wholly owned subsidiary of AIB Group plc. Pursuant to a Scheme of Arrangement between AIB Bank and its shareholders, AIB Group plc became the holding company of AIB and its subsidiaries, including EBS and the Bank on 8 December 2017.

AIB and its subsidiaries, including the Bank, 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's debt securities are listed on the main securities market of the Irish Stock Exchange.

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 2018 will continue to entail the provision of liquidity to AIB 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. 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 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 Group plc. Governance is exercised through a Board of Directors ('the Board') and a Senior Management Team. The conditions of the Bank's Central Bank licence require that there should be a minimum of two Non-Executive Directors who are independent of the parent company. Throughout 2017, there were 8 Directors on the Board. The previous Managing Director resigned and was replaced by a new Managing Director on 6 April 2017. There was a Group Non-Executive Director also appointed on that date and two Independent Non-Executive Directors appointed on 29 November 2017. As of 31 December 2017, the Board comprised of 4 Independent Non-Executive Directors, 1 Group Non-Executive Director and 2 Executive Directors, 1 of which is the Managing Director.

Directors' Report (continued)

Corporate Governance (continued)

The Board of Directors (continued)
The Board is responsible for ensuring that appropriate systems of internal controls and risk management are maintained, specifically the Board sets the Risk Appetite Statement, approves the Risk Framework and approves the annual financial plans. The Bank benefits as a subsidiary of AIB from the wider AIB governance and operating structure, such as oversight of audit and risk related activities. AIB and EBS provide services to the Bank through 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 2017, considered the outcome of internal and external audit activities.

The Board held 4 scheduled meetings during 2017 and 1 out of course meeting was also held further detail about Directors' attendance of the meetings can be found in the table on page 9.

The Bank is subject to the CBI's Corporate Governance Requirements for Credit Institutions 2015 ("the 2015 Requirements") (which are available on www.centralbank.ie), which became effective for all credit institutions on 11 January 2015. 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 a Director resignation in September 2016, the Bank was not compliant with the 2015 Requirements as it is required to have 5 Directors on the Board. The three appointments to the Board during 2017 noted previously, the first of which took effect from 6 April 2017, brought the Bank back into compliance with the 2015 Requirements and, as at 31 December 2017, there were 7 Directors on the Board of the Bank.

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 2017 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 AIB Internal Audit. The Board satisfied itself through regular reports from AIB Internal Audit, AIB Risk, 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 the Bank were effective. The Board is satisfied that appropriate measures are taken to consider and address any control issues identified by AIB Internal Audit.

Directors’ Report (continued)

Results for the year

Net interest income (‘NII’)	**2017** 2016	**€165m** €170m	Reduction in NII, being impact of 2016 and 2017 fixed and variable price reductions and increased funding costs due to the application of a new transfer pricing agreement.
Administrative expenses	**2017** 2016	**€98m** €5m	In 2017, expenses increased by €93m with amounts payable to EBS €88m higher following the implementation of a revised transfer pricing arrangement for 2017 which resulted in additional allocated charges (further details below).
Profit before tax	**2017** 2016	**€30m** €138m	The reduction in profit before tax is largely driven by the transfer price change with EBS.
Loans & receivables to customers	**2017** 2016	**€4,450m** €4,880m	In 2017 gross mortgage balances fell by €427m, due to repayments, restructures and sale of a portfolio of impaired loans €20m. In addition there was an increase in provision stock of €3m consisting of a provision charge €40m offset by amounts written off €37m.
Deposits by banks	**2017** 2016	**€1,723m** €2,674m	Borrowings from EBS fell by €951m during 2017 due to the issuance of €500m covered bonds in November 2017 and the reduction in loans and receivables to customers.
Debt securities in issue	**2017** 2016	**€2,022m** €1,500m	The Bank issued the Series 17 covered bonds of €500m to EBS in November 2017.
Total Tier 1 ratio (transitional)	**2017** 2016	**36.3%** 30.9%	Reduction of €287m in risk weighted assets and core equity tier 1 capital increase of €26m in 2017.

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

The impact of implementing the new transfer pricing agreement which attributes an arm’s length Return on Equity to the Bank of €26m, is an increase in Administrative expenses for 2017 of €88m, being the primary reason for the reduction in profit after tax to €26m (2016: €121m). The additional charge is in respect of credit management, central function costs, risks borne by and assets provided by AIB in facilitating the operations of the Bank.

Business review
The Irish economy improved generally during 2017 including a decreasing unemployment rate standing at 6.2% at the end of December 2017 against 7.2% in 2016 (Source: Central Statistics Office) and decreasing mortgage arrears. Total market mortgage drawdowns in Ireland were €7.3bn (Source: Banking & Payments Federation of Ireland (‘BPFI’)) in 2017 compared with €5.7bn in 2016, an increase of 28%.

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

The Bank’s loan portfolio before provisions decreased by 8.3% during 2017 to €4.7bn as at 31 December 2017 principally due to customer’s repayments and loan restructuring (2016: decrease 6.8%).

Directors' Report (continued)

Business review (continued)
The Bank's residential mortgage portfolio comprises gross loan balances of €4.7bn owner occupier (2016: €5.2bn) and €0.01bn buy-to-let mortgages (2016: €0.02bn). At 31 December 2017, the Bank's mortgage loans accounted for 13.9% (2016: 14.8%) of AIB's residential mortgage portfolio of €33.7bn (2016: €35.2bn).

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 25% to €0.6bn, equal to 13% of total loans (2016: €0.8bn or 22%).

In 2015, the Bank created a provision of €21m related to the expected outflow for customer redress and compensation in respect of tracker mortgages where rates given to customers were either not in accordance with original contract terms or where the transparency of terms did not conform to that which a customer could reasonably expect (Tracker Mortgage Examination). Over the past two years over 150 customers were redressed and compensated. Over the past two years €16m was written back to the income statement, and the remaining provision for customer redress and compensation of €5m was fully utilised at 31 December 2017.

The Bank continues to face challenges like the Tracker Mortgage Examination programme. As they arise, the Bank together with AIB commit the required resources to deal with them in an open and fair way for our customers and stakeholders. That is what is expected of us and it is how the Bank will continue to rebuild trust and public confidence. The Tracker Mortgage Examination programme has been a long programme, which started in 2015 and is now defined by the Central Bank of Ireland Framework. This includes a full independent third party review and an appeals process, which takes time to complete. Customers are assured that payments they receive under the redress and compensation scheme will not compromise their right to appeal so we can reasonably expect that activities might flow on from this for some time. We have made very material progress and expect to conclude the main customer elements by Q2 2018.

The final redress and compensation is subject to independent third party assurance and is also subject to assessment and challenge by the Central Bank, notwithstanding the advanced stage of the examination process in the Bank.

In 2015, the Bank also created a provision of €14m with regard to 'Other costs'. €9m was written back to the income statement in 2017. Over the past two years €4m was utilised bringing the provision for 'Other costs' to €1m at 31 December 2017.

Funding activities
There was a favourable technical market backdrop for covered bonds in 2017, with the ECB's covered bond purchase programme (CBPP3) continuing to actively buy bonds in both the primary and secondary markets during the year. CBPP3 is aimed at enhancing the functioning of the monetary policy transmission mechanism, supporting financing conditions in the euro area, and facilitating credit provision to the real economy. As of March 21, 2018 the holdings under CBPP3 amount to circa €247bn (2016: c. €214bn). The ECB left the main refinancing rate unchanged in 2017 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 2017, supported by CBPP3 buying and a reduction in net supply as issuers utilised other funding sources, such as the ECB's Targeted Long Term Refinancing Operation scheme (TLTROII).

At 31 December 2017, the total amount of principal outstanding in respect of mortgage covered securities issued was €2bn (31 December 2016: €1.5bn) subscribed for in full by EBS. The Bank issued the Series 17 covered bonds of €500m in November 2017.

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

Rating Agency	**EBS Mortgage Finance Covered Bond Programme**	**AIB Issuer default rating**	**Ireland (Sovereign)**
Moody's	**Aaa**	**Baa2**	**A2**

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

Directors’ Report (continued)

Share capital

The share capital of the Bank is €552m (2016: €552m), comprised of ordinary shares of €1 each. 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 17 of the financial statements.

Capital resources and regulatory capital ratios

The table below shows the components of the Bank’s Common equity Tier 1 and total capital ratios as at 31 December 2017 and 31 December 2016.

	CRD IV Transitional basis		CRD IV Fully loaded	
	31 December 2017	31 December 2016	**31 December 2017**	31 December 2016
	€ m	€ m	**€ m**	€ m
Shareholders’ equity	**773**	747	**773**	747
Total Tier 1 capital	**773**	747	**773**	747
Tier 2 Capital				
Credit provisions	**12**	17	**-**	-
Total Tier 2 capital	**12**	17	**-**	-
Total capital	**785**	764	**773**	747
Risk Weighted Assets				
Credit risk	**1,959**	2,294	**1,959**	2,294
Operational risk	**173**	125	**173**	125
Total Risk Weighted Assets	**2,132**	2,419	**2,132**	2,419
Total Tier 1 capital ratio	**36.3%**	30.9%	**36.3%**	30.9%
Total capital ratio	**36.8%**	31.6%	**36.3%**	30.9%

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.

The Bank is required to maintain a Common Equity Tier 1 ratio of 6.375% effective from 1 January 2018 (2017: 5.75%). This includes a Pillar 1 requirement of 4.5% and a capital conservation buffer (“CCB”) of 1.875% (2016: 1.25%). The minimum requirement for the transitional total capital ratio is 9.875% (2017 9.25%). The transitional CET1 and total capital ratios at 31 December 2017 were 36.8% and 36.3 % respectively (2016: 31.6% and 30.9% respectively). These ratios are significantly in excess of the regulatory requirements.

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

Risk Management

The Bank adopts the same risk management framework and risk mitigation initiatives as AIB. The risk management framework provides a Group-wide definition of risk and lays down principles of how risk is to be identified, assessed, measured, monitored and controlled / mitigated, and the associated allocation of capital against same. Further information in relation to Risk Management, including the principal risks and uncertainties facing the Bank, as required under the terms of the European accounts Modernisation Directive (2003/51/EEC) (implemented in Ireland by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005) is set out in the Risk Management Report on pages 11 to 47.

Directors' Report (continued)

Outlook and priorities for 2018

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

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

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

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

Going concern

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

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

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

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

Directors' Report (continued)

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

Shares held by the Directors in ultimate parent company AIB Group plc were below 1% and not disclosable under the Companies Act 2014.

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

Long term incentive plans
There were no conditional grants of awards of ordinary shares outstanding to Executive Directors or the Company Secretary at 31 December 2017. Independent Non-Executive Directors do not participate in long term incentive plans.

Attendance at scheduled Board Meetings

	Scheduled Meetings		**Out of course**	
Directors	**A**	**B**	**A**	**B**
Denis Holland	4	4	1	1
Niamh Carolan	*3*	*3*	*0*	*0*
William Cunningham	4	4	1	1
Chris Curley	3	3	0	0
Gerry Gaffney	4	3	1	1
Brendan McDonagh	1	1	0	0
Jim O'Hara	1	1	0	0
Owen Purcell (resigned 06/04/2017)	1	1	1	1

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

Directors and Secretary during the year
The following were Directors of the Bank during 2017 – Denis Holland, Niamh Carolan (with effect from 6 April 2017), William Cunningham, Chris Curley (with effect from 6 April 2017), Gerry Gaffney, Brendan McDonagh (with effect from 29 November 2017), Jim O'Hara (with effect from 29 November 2017) and Owen Purcell (resigned 6 April 2017).

On 18 December 2017, Ms. Catherine Kelly resigned as Company Secretary and Ms. Cara Teahan was appointed on the same date.

There were no changes in the Directors' and Secretary's interests between 31 December 2017 and 23 March 2018.

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

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

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

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

Directors' Report (continued)

Branches outside the State

The Bank has not established any branches outside the State.

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

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

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 Auditors are unaware; and
b) the Director has taken all steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that the Auditors are 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, were appointed on 30 July 2013 and have expressed their willingness to continue in office under Section 383(2) of the Companies Act 2014.

On behalf of the Board,

Denis Holland	Chris Curley
Chairman	Managing Director

23 March 2018

Risk Management Report

1. Introduction

The Bank's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed on an AIB-wide basis. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of the AIB's risk management framework. The Bank experiences similar risks and uncertainties to AIB and adopts the same risk mitigation initiatives as AIB.

2. Risk framework

The Bank relies on the AIB framework and its supporting policies, processes and governance. For more information on the operation of the Board of the Bank see page 3 and 4 of this Report.

3. Individual risk types

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

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

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

Risk Management Report (continued)

3.1 Credit risk

Credit risk is the risk that the Bank will incur losses as a result of 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.

Credit risk organisation and structure

AIB's credit risk management systems operate through a hierarchy of lending authorities. The Bank relies on the AIB credit 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 Credit Risk function is to provide direction, oversight and challenge of credit risk-taking. Credit Risk appetite is set at AIB Board level and the Bank's Risk Appetite Statement (RAS) is fully aligned with the AIB RAS. The EBS RAS is reviewed by the AIB Board prior to final approval by the EBS Board. The Bank's Credit Risk appetite 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 EBS'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 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 their obligations;
- Exposure at default ("EAD") – the exposure to a borrower who is unable to repay their obligations at the point of default;
- Loss given default ("LGD") – the loss associated with a defaulted loan or borrower; and
- Expected loss ("EL") – the loss that can be incurred as a result of lending to a borrower that may default. It is the average expected loss in value over a specified period.

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

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

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

Credit grading and scoring systems facilitate the early identification and management of any deterioration in loan quality. Changes in the objective information are reflected in the credit grade of the borrower with the resultant grade influencing the management of individual loans. Special attention is paid to lower quality performing loans or 'criticised' loans.

3.1 Credit risk (continued)

Measurement of credit risk (continued)
In the Bank, criticised loans include ‘watch’, ‘vulnerable’ and ‘impaired’ loans which are defined as follows:

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

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.

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

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

Maximum exposure to credit risk*

			2017			2016
	Amortised Cost	**Fair Value**	**Total**	Amortised Cost	Fair Value	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Derivative financial instruments	**-**	**20**	**20**	-	19	19
Loans and receivables to banks	**69**	**-**	**69**	49	-	49
Loans and receivables to customers	**4,450**	**-**	**4,450**	4,880	-	4,880
Included elsewhere:						
Accrued interest	**-**	**-**	**-**	-	-	-
Other assets	**-**	**-**	**-**	-	-	-
	4,519	**20**	**4,539**	4,929	19	4,948
Off balance sheet loan commitments	**12**	**-**	**12**	10	-	10
Maximum exposure to credit risk	**4,531**	**20**	**4,551**	4,939	19	4,958

Risk management and mitigation
The Bank has an established credit process through AIB with a framework of a mortgage credit policy and delegated authorities, based on skill and experience, for the management and control of credit risk. A credit risk framework sets out at a high level, how AIB identifies, assesses, approves, monitors, repairs and controls credit risk. It contains minimum standards that are applied across AIB to provide a common and consistent approach to the management of credit risk. Credit grading, scoring and monitoring systems accommodate the early identification and management of any deterioration in loan quality. The credit management system is underpinned by an independent system of credit review. This includes cyclical credit reviews, non-standard reviews and bespoke assignments including impairment adequacy reviews as required.

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

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Collateral*

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

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

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

				2017
	Neither past due nor impaired	**Past due but not impaired**	**Impaired**	**Total**
Fully collateralised	**€ m**	**€ m**	**€ m**	**€ m**
Loan-to-value ratio:				
Less than 50%	**1,196**	**38**	**57**	**1,291**
50%-70%	**1,011**	**43**	**72**	**1,126**
71%-80%	**456**	**22**	**48**	**526**
81%-90%	**442**	**16**	**52**	**510**
91%-100%	**358**	**12**	**56**	**426**
	3,463	**131**	**285**	**3,879**
Partially collateralised				
Collateral value relating to loans over 100% LTV	**467**	**27**	**251**	**745**
Total collateral value	**3,930**	**158**	**536**	**4,624**
Gross residential mortgages	**3,970**	**162**	**608**	**4,740**
Statement of financial position specific provisions			**(243)**	**(243)**
Statement of financial position IBNR provisions				**(47)**
Net residential mortgages				**4,450**

The decrease in the collateral values for impaired loans reflects the reduction in impaired loans during 2017, largely due to loans curing from impairment and write-offs.

				2016
	Neither past due nor impaired	Past due but not impaired	Impaired	Total
Fully collateralised	€ m	€ m	€ m	€ m
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
Partially collateralised				
Collateral value relating to loans over 100% LTV	877	39	344	1,260
Total collateral value	4,122	152	627	4,901
Gross residential mortgages	4,254	160	753	5,167
Statement of financial position specific provisions			(258)	(258)
Statement of financial position IBNR provisions				(29)
Net residential mortgages				4,880

* Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

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

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

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

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

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

AIB has introduced a Mortgage Arrears Resolution Process (“MARP”) for dealing with mortgage customers in difficulty or likely to be in difficulty. The core objectives of this process is to ensure that arrears solutions are sustainable in the long term and that they comply with the spirit and the letter of all regulatory requirements. It includes long-term forbearance solutions which have been devised to assist existing Republic of Ireland primary residential mortgage customers in difficulty.

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

The four step process is summarised as follows:
- Communications – We are here to listen, support and provide advice;
- Financial information – To allow us to understand the customer finances;
- Assessment – Using the financial information to assess the customer’s situation;
- Resolution – We work with the customer to find a resolution.

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

Low fixed interest rate sustainable solution – This solution is to support customers who have an income (and can afford a mortgage), but the income is not currently sufficient to cover full capital and interest on their mortgage based on their current interest rate(s) and/or personal circumstances. Their current income is, however, sufficient to cover full capital and interest at a lower rate. It involves the customer being provided with a low fixed interest rate for an agreed period after which the customer will convert to the prevailing 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;

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Forbearance strategies* (continued)

Negative equity trade down – This allows a customer to sell their house and subsequently purchase a new property and transfer the negative equity portion 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;

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; and

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

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

Loan loss provisioning

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

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

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

It is the Bank’s policy to provide for impairment promptly and consistently across the loan book. All business areas formally review and confirm the appropriateness of their provisioning methodologies and the adequacy of their impairment provisions on a quarterly basis. Loans are tested for impairment on receipt of a forbearance request and typically 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:

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

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

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

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

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

* Forms an integral part of the audited financial statements.

3.1 Credit risk (continued)

Loan loss provisioning (continued)

Specific provisions*

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

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

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, owner occupier and buy to let 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 updated market and transactional data.

Key model parameters at 31 December 2017 for owner occupier mortgages are as follows: cure (19%) and disposal/ forbearance (81%) (2016: cure 14% and disposal/forbearance 86%). The corresponding buy-to-let model parameters are as follows: cure (11%); disposal/forbearance (89%) (2016: cure 7% and disposal/forbearance 93%). The cure rate parameter in the individually insignificant model reflects the percentage of loans which were 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: likelihood of property disposal, haircut; costs and time to dispose (voluntary and forced); house price fall from peak and loss rate on advanced forbearance.

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

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Loan loss provisioning (continued)

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

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

- historical loss experience (loss emergence rates based on historic grade migration experience or probability of default) in portfolios of similar credit risk characteristics (for example, by sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate provision against the individual loan (emergence period);
- loss given default rates based on historical loan loss experience, adjusted for current observable data;
- management’s 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 forborne mortgages and restructured loans.

Risk Management Report (continued)

3.1 Credit risk (continued)

Loan loss provisioning (continued)

Incurred But Not Reported Provisions (IBNR) (continued)
The residential mortgage portfolio IBNR is calculated using the individually insignificant and IBNR mortgage model described above. The IBNR is calculated as PD multiplied by LGD, multiplied by Exposure (adjusted for the Emergence Period) with the PD and LGD derived from statistical models. Cured and Forborne non-impaired loans are higher stressed and are therefore, assigned a higher PD. The table below sets out the parameters used in the calculation of IBNR provisions for the residential mortgages portfolio:

2017

	Owner-Occupier			**Buy-to-let**		
Grade	**Exposure € m**	**Average PD %**	**Average LGD %**	**Exposure € m**	**Average PD %**	**Average LGD %**
Good upper[1]	**3,310**	**0.5**	**18.5**	**7**	**2.0**	**27.2**
Good lower[2]	**458**	**3.5**	**21.9**	**2**	**3.2**	**48.3**
Watch	**318**	**15.2**	**21.7**	**-**	**94.9**	**28.4**
Vulnerable	**37**	**53.5**	**21.8**	**-**	**72.4**	**37.0**

[1] Good upper: Strong credit with no weakness evident. Typically includes elements of the residential mortgages portfolio combined with strong corporate and commercial lending.
[2] Good lower: Satisfactory credit with no weakness evident. Typically includes new business written and existing satisfactorily performing exposures across all portfolios.

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

Cured	**124**	**9.0**	**23.9**	**-**	**2.2**	**13.7**
Forborne – Non impaired	**810**	**6.7**	**21.6**	**1**	**14.0**	**30.6**

2016

	Owner-Occupier			**Buy-to-let**		
Grade	Exposure € m	Average PD %	Average LGD %	Exposure € m	Average PD %	Average LGD %
Good upper	3,325	0.6	14.6	6	2.0	21.7
Good lower	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

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

Cured	225	12.3	20.0	1	68.0	31.4
Forborne – Non impaired	787	8.0	17.7	1	14.0	25.0

The parameters for Cured and Forborne non-impaired, are as follows:
Average PD and LGD are based on the PDs and LGDs, weighted by the EAD for all owner-occupier and buy-to-let loans included in the individually insignificant and IBNR mortgage model. The mortgage provision model calculates individually insignificant specific provisions and IBNR provisions.

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

Risk Management Report (continued)

3.1 Credit risk (continued)

Loan loss provisioning (continued)

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

Emergence periods are reflective of the characteristics of the particular portfolio. Emergence periods are estimated based on historic loan loss experience supported by back testing, and, as appropriate, individual case sampling. Emergence periods are reviewed on at least an annual basis. At 31 December 2017, there was no change made to the emergence period for the mortgage portfolio (12 months).

Approval process*
AIB operates an approval framework for impairment provisions which are approved, depending on amount, by various delegated authorities and referred to Area Credit Committee level, as required. These committees are chaired by a designated Credit Risk representative as outlined in the terms of reference for Credit Committees (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 GCC 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 by AIB 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.

Reversal of impairment*
If the amount of an impairment loss decreased in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment provision 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 reporting 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 vintage, 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.

3.1 Credit risk (continued)

Loan loss provisioning (continued)

Impact of changes to key assumptions and estimates on the impairment provisions* (continued)
However, the exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas.

In assessing the value of collateral for collectively provided impaired mortgage loans in the Republic of Ireland, AIB has used a house price fall from peak of 32% Dublin and 37% non-Dublin which determines the collateral value supporting loans in the mortgage portfolio and cure rates (rates by which defaulted or delinquent accounts are assumed to return to performing status) (2016: 40% and 44% respectively).

AIB's buffer to the latest available CSO index remained unchanged at 10% throughout 2017.

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 0.7% (blended rate of owner-occupier/buy-to-let) or c. €2m. December 2016 equivalent: reduction of 0.5% or c. €1.5m.

The value of collateral is estimated by applying changes in house price indices to the original assessed value of the property. A 1% change in the house price fall from peak assumption used for the collective mortgage provisions for December 2017 is estimated to result in movements in provisions of c. €2.8m. December 2016 equivalent: €3.7m.

A 1% move in the haircut for a Dublin sale would result in a change of €0.8m in provisions, (€0.7m Individually Insignificant and €0.1m IBNR). December 2016 equivalent: €1m (€0.9m II and €0.1m IBNR). A 1% move in the haircut for a sale outside Dublin would result in a change of €2m in provisions, (€1.8m II and €0.2m IBNR). December 2016 equivalent: €2.2m (€2.0m II and €0.2m IBNR).

An increase in the assumed repossession rate of 1% for collective mortgage provisions would result in an increase in provisions of 0.6% (blended rate of owner-occupier/buy-to-let) or c. €1.6m. December 2016 equivalent: increase of 0.8% or c. €2.5m.

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Loan loss provisioning (continued)

Impact of changes to key assumptions and estimates on the impairment provisions* (continued)
An IBNR provision is made for impairments that have been incurred but have not been separately identifiable at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Bank's mortgage portfolio, the emergence period is currently 12 months; a decrease of one month in the loss emergence period in respect of the loan portfolio assessed would result in a decrease of c. €1.9m to the IBNR provision (2016: €2m).

Individually impaired loans by geographic location and sector*	**2017**	2016
	€ m	€ m
Republic of Ireland		
Residential Mortgages	**608**	753
	608	753

Provision cover table

	Impaired Loan Balance	**Specific Provision**	**Specific Provision Cover %**
Residential mortgages – 31 December 2017	**608**	**243**	**40%**
Residential mortgages – 31 December 2016	753	258	34%

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

(i) The higher concentration of loans in the legal process, which take longer to resolve and typically require higher provision cover;
(ii) 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; and
(iii) Extended time to disposal parameters which reflect the execution risks in the resolution of mortgage loans in the legal process.

*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

			2017*			2016*
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Total gross residential mortgages	**4,728**	**12**	**4,740**	5,150	17	5,167
In arrears >30 days past due and/or impaired	**633**	**4**	**637**	777	7	784
In arrears >90 days past due and/or impaired	**605**	**3**	**608**	746	7	753
Of which impaired	**605**	**3**	**608**	746	7	753
Statement of financial position specific provisions	**241**	**2**	**243**	254	4	258
Statement of financial position IBNR provisions	**47**	**-**	**47**	29	-	29

Total impaired loans amounted to €608m at 31 December 2017 (2016: €753m), of which €27m (2016: €27m) was individually assessed for impairment and €581m (2016: €726m) was collectively assessed for impairment.

Provision cover percentage*

			2017			2016
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	%	**%**	**%**	%	%	%
Specific provisions as a % of impaired loans cover	**39.8**	**66.7**	**40.0**	34.0	57.1	34.3

The specific provision cover level increased in 2017. The increase was primarily due to provision top-ups and parameter changes in the mortgage provisioning model as set out on the previous page.

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Loan loss provisioning (continued)

Income statement (2)

	2017*			2016*		
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Income statement specific provisions	**22**	**-**	**22**	19	-	19
Income statement IBNR provisions	**17**	**1**	**18**	1	-	1
Total impairment provisions	**39**	**1**	**40**	20	-	20

The increased IBNR charge in 2017 of €18m (2016: €1m) has been driven by changes in the Individually Insignificant mortgage model, most notably in the time to disposal parameter.

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

Asset quality of residential mortgages*

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

	2017*			2016*		
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Satisfactory	**3,768**	**9**	**3,777**	3,955	10	3,965
Watch	**318**	**-**	**318**	403	-	403
Vulnerable	**37**	**-**	**37**	46	-	46
Impaired	**605**	**3**	**608**	746	7	753
Criticised	**960**	**3**	**963**	1,195	7	1,202
Gross mortgages	**4,728**	**12**	**4,740**	5,150	17	5,167
	%	**%**	**%**	%	%	%
Criticised loans as % of total mortgages	**20.3**	**25.0**	**20.3**	23.2	41.2	23.3
Impaired loans as % of total mortgages	**12.8**	**25.0**	**12.8**	14.5	41.2	14.6

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

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

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

The following tables profile the residential mortgage portfolio that was past due but not impaired at 31 December 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
1 - 30 days	**134**	**1**	**135**	129	-	129
31 - 60 days	**20**	**-**	**20**	23	-	23
61 - 90 days	**7**	**-**	**7**	8	-	8
91 - 180 days	**-**	**-**	**-**	-	-	-
181 - 365 days	**-**	**-**	**-**	-	-	-
Over 365 days	**-**	**-**	**-**	-	-	-
Total past due but not impaired	**161**	**1**	**162**	160	-	160

Arrears profile of mortgages which were impaired*

The following tables profile the residential mortgage portfolio that was impaired at 31 December 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Not past due	**94**	**-**	**94**	159	-	159
1 - 30 days	**30**	**-**	**30**	36	1	37
31 - 60 days	**14**	**-**	**14**	16	-	16
61 - 90 days	**13**	**-**	**13**	13	-	13
91 - 180 days	**36**	**-**	**36**	47	-	47
181 - 365 days	**39**	**-**	**39**	47	1	48
Over 365 days	**379**	**3**	**382**	428	5	433
Total impaired	**605**	**3**	**608**	746	7	753

Impaired loans decreased by €145m during 2017 due to loans curing from impairment and write-offs of provisions. Of the residential mortgage portfolio that was impaired at 31 December 2017, €94m or 15% was not past due (31 December 2016: €159m or 21%), of which €86m (31 December 2016: €139m) was subject to forbearance measures at 31 December 2017.

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Forbearance
AIB has introduced a Mortgage Arrears Resolution Process ("MARP") for dealing with mortgage customers in difficulty or likely to be in difficulty. The core objectives of this process is to ensure that arrears solutions are sustainable in the long term and that they comply with the spirit and the letter of all regulatory requirements. It includes long-term forbearance solutions which have been devised to assist existing Republic of Ireland primary residential mortgage customers in difficulty.

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

(i) Total mortgage portfolio – subject to forbearance

		2017		2016
	Number	**Balance €m**	Number	Balance €m
At 1 January	**7,548**	**1,006**	8,644	1,051
Additions	**463**	**58**	1,019	142
Expired arrangements	**(1,766)**	**(223)**	(850)	(96)
Payments	**-**	**(49)**	-	(58)
Interest	**-**	**27**	-	31
Closed accounts[(1)]	**(255)**	**(16)**	(276)	(14)
Advanced Forbearance Arrangements - Valuation Adjustments	**-**	**(2)**	-	2
Write-Offs[(2)]	**(19)**	**(4)**	(4)	(1)
Transfer from owner-occupier to buy-to-let	**(1)**	**-**	-	-
Adoption of EBA forbearance definition	**-**	**-**	(985)	(51)
At 31 December	**5,970**	**797**	7,548	1,006

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

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

Residential mortgages subject to forbearance measures decreased by €209m in 2017 (2016: decrease of €45m). This decrease is mainly driven by €223m of mortgages exiting forbearance in the year, having met the forbearance terms, and lower numbers of customers seeking new forbearance solutions which is reflective of improving customer ability to meet their mortgage terms. This has been driven by AIB's strategy to deliver sustainable long-term solutions to customers and support customers in remaining in their family home.

3.1 Credit risk (continued)

Forbearance (continued)

(ii) Owner-occupier mortgages – subject to forbearance

	2017		2016	
	Number	**Balance €m**	Number	Balance €m
At 1 January	**7,527**	**1,003**	8,619	1,048
Additions	**462**	**58**	1,018	142
Expired arrangements	**(1,757)**	**(222)**	(845)	(95)
Payments	**-**	**(49)**	-	(58)
Interest	**-**	**27**	-	31
Closed accounts[1]	**(253)**	**(16)**	(273)	(14)
Advanced Forbearance Arrangements - Valuation Adjustments	**-**	**(2)**	-	2
Write-Offs[2]	**(19)**	**(4)**	(4)	(1)
Transfer from owner-occupier to buy-to-let	**1**	**-**	-	-
Adoption of EBA forbearance definition	**-**	**-**	(988)	(52)
At 31 December	**5,961**	**795**	7,527	1,003

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

	2017		2016	
	Number	**Balance €m**	Number	Balance €m
At 1 January	**21**	**3**	25	3
Additions	**1**	**-**	1	-
Expired arrangements	**(9)**	**(1)**	(5)	(1)
Closed accounts[1]	**(2)**	**-**	(3)	-
Transfer from owner-occupier to buy-to-let	**(2)**	**-**	-	-
Adoption of EBA forbearance definition	**-**	**-**	3	1
At 31 December	**9**	**2**	21	3

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

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

Risk Management Report (continued)

3.1 Credit risk (continued)

Forbearance (continued)

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

(i) Total mortgage portfolio

	2017*					
	Total		**Loans >90 days in arrears and/or impaired**		**Loans neither >90 days in arrears nor impaired**	
	Number	**Balance € m**	**Number**	**Balance € m**	**Number**	**Balance € m**
Interest only	**1,464**	**218**	**891**	**145**	**573**	**73**
Low fixed interest rate	**354**	**56**	**56**	**9**	**298**	**47**
Arrears capitalisation	**3,093**	**402**	**959**	**122**	**2,134**	**280**
Term extension	**120**	**9**	**41**	**3**	**79**	**6**
Split mortgage	**480**	**76**	**123**	**20**	**357**	**56**
Sale for loss	**109**	**3**	**63**	**2**	**46**	**1**
Positive equity solution	**349**	**33**	**30**	**3**	**319**	**30**
Other	**1**	**-**	**1**	**-**	**-**	**-**
Total	**5,970**	**797**	**2,164**	**304**	**3,806**	**493**

	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
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	-	-	-	-	-	-
Total	7,548	1,006	2,614	376	4,934	630

The decrease of €88m in arrears capitalisations in 2017 was largely driven by customer exiting forbearance having met their forbearance terms, and lower numbers of customers seeking new forbearance solutions which is reflective of improved customer ability to meet their mortgage terms.

Interest income on impaired loans amounted to €12m in 2017 (2016: €16m). At 31 December 2017, the net carrying value of impaired loans amounted to €361m (€604m Impaired Balance - €243m Closing Specific Provision) (2016: €494m) which included forborne impaired mortgages of €202m (€304m Forborne Impaired Balance - €102m Forborne Closing Specific Provision) (2016: €272m).

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Forbearance (continued)

(ii) Owner-occupier mortgages

2017*

	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	**Balance € m**	**Number**	**Balance € m**	**Number**	**Balance € m**
Interest only	**1,461**	**217**	**888**	**144**	**573**	**73**
Low fixed interest rate	**354**	**56**	**56**	**9**	**298**	**47**
Arrears capitalisation	**3,090**	**401**	**958**	**122**	**2,132**	**279**
Term extension	**120**	**9**	**41**	**3**	**79**	**6**
Split mortgage	**480**	**76**	**123**	**20**	**357**	**56**
Sale for loss	**106**	**3**	**61**	**2**	**45**	**1**
Positive equity solution	**349**	**33**	**30**	**3**	**319**	**30**
Other	**1**	**-**	**1**	**-**	**-**	**-**
Total	**5,961**	**795**	**2,158**	**303**	**3,803**	**492**

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	1,663	248	1,016	164	647	84
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	-	-	-	-	-	-
Total	7,527	1,003	2,605	375	4,922	628

*Forms an integral part of the audited financial statements.

3.1 Credit risk (continued)

Forbearance (continued)

(iii) Buy-to-let mortgages

2017*

	Total		**Loans >90 days in arrears and/or impaired**		**Loans neither >90 days in arrears nor impaired**	
	Number	**Balance € m**	**Number**	**Balance € m**	**Number**	**Balance € m**
Interest only	**3**	**1**	**3**	**1**	**-**	**-**
Arrears capitalisation	**3**	**1**	**1**	**-**	**2**	**1**
Sale for loss	**3**	**-**	**2**	**-**	**1**	**-**
Total	**9**	**2**	**6**	**1**	**3**	**1**

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	-
Arrears capitalisation	12	1	4	-	8	1
Sale for loss	4	1	3	-	1	1
Total	21	3	9	1	12	2

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Forbearance (continued)

Credit profile of residential mortgages in forbearance*

Analysis by Loan-to-value ('LTV') of residential mortgages in forbearance
The following table profiles the residential mortgage portfolio that was subject to forbearance measures by the indexed loan-to-value ratios at 31 December 2017 and 31 December 2016:

			2017			2016
	Owner-Occupier	**Buy-to-let**	**Total**	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Less than 50%	**135**	**-**	**135**	135	-	135
50% - 70%	**175**	**-**	**175**	179	-	179
71% - 80%	**90**	**-**	**90**	114	-	114
81% - 90%	**85**	**1**	**86**	108	-	108
91% - 100%	**83**	**-**	**83**	85	1	86
101% - 120%	**151**	**1**	**152**	181	1	182
121% - 150%	**62**	**-**	**62**	173	-	173
Greater than 150%	**10**	**-**	**10**	20	-	20
Unsecured (Zero Collateral)	**4**	**-**	**4**	8	1	9
Total forbearance	**795**	**2**	**797**	1,003	3	1,006

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Forbearance (continued)

Credit profile of residential mortgages in forbearance* (continued)

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

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was past due but not impaired at 31 December 2017 and 31 December 2016:

	2017			2016		
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
1 - 30 days	**67**	**-**	**67**	66	-	66
31 - 60 days	**13**	**-**	**13**	16	-	16
61 - 90 days	**5**	**-**	**5**	4	-	4
91 - 180 days	**-**	**-**	**-**	-	-	-
181 - 365 days	**-**	**-**	**-**	-	-	-
Over 365 days	**-**	**-**	**-**	-	-	-
Total past due but not impaired	**85**	**-**	**85**	86	-	86

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

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

	2017			2016		
	Owner-Occupier	**Buy-to-Let**	**Total**	Owner-Occupier	Buy-to-Let	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Not past due	**86**	**-**	**86**	139	-	139
1 - 30 days	**26**	**-**	**26**	32	-	32
31 - 60 days	**11**	**-**	**11**	12	-	12
61 - 90 days	**10**	**-**	**10**	10	-	10
91 - 180 days	**28**	**-**	**28**	33	-	33
181 - 365 days	**30**	**-**	**30**	33	-	33
Over 365 days	**112**	**1**	**113**	116	1	117
Total impaired	**303**	**1**	**304**	375	1	376

The proportion of forbearance that is impaired increased slightly from 37% at 31 December 2016 to 38% at 31 December 2017. The proportion of forborne impaired loans that were not past due decreased from 37% at 31 December 2016 to 28% at 31 December 2017, mainly due to cases exiting their forbearance period.

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Properties in possession
The Bank seeks to avoid repossession through working with customers, but where agreement cannot be reached, the Bank 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 the Bank 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 the Bank'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.

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

	2017		2016	
	Stock	**Balance Outstanding € m**	Stock	Balance Outstanding € m
Owner-occupier	**176**	**45**	210	52
Buy-to-let	**1**	**-**	4	1
Total	**177**	**45**	214	53

The stock of residential properties in possession decreased by 37 properties in 2017. This decrease relates to the disposal of 62 properties (31 December 2016: 55 properties) which were offset by the addition of 28 properties (31 December 2016: 89 properties).

In addition, a further 3 properties were removed from the stock in 2017 as part of the sale of a portfolio of distressed mortgages.

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

2017

	Number of Disposals	**Balance outstanding at repossession date € m**	**Gross sales proceeds € m**	**Costs to sell € m**	**Loss on sale[(1)] € m**	**Average LTV at sale Price %**
Owner-occupier	**62**	**18**	**11**	**1**	**8**	**160%**
Buy-to-let	**-**	**-**	**-**	**-**	**-**	**-**
Total residential	**62**	**18**	**11**	**1**	**8**	**160%**

2016

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

[(1)] Before specific impairment provisions.

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

The disposal of 62 residential properties resulted in a loss on disposal of €8 million at 31 December 2017 (before specific impairment provisions), (2016: 55 disposals, and €9 million loss on disposal).

Risk Management Report (continued)

3.1 Credit risk (continued)

Loan-to-value (LTV) (index linked) information
The property values used in the completion of the following loan-to-value tables are determined with reference to the original or most recent valuation, indexed to the Central Statistics Office ("CSO") Residential Property Price Index in the Republic of Ireland for October 2017. The CSO Residential Property Price Index for October 2017 reported that national residential property prices were 24% lower than their highest level in early 2007 and reported an annual increase in residential property prices of 12% for the twelve months to October 2017.

Actual and average LTV across mortgage portfolios
The following tables profile the residential mortgage portfolio by the indexed loan-to-value ('LTV') ratios and the weighted average indexed LTV ratios at 31 December 2017 and 31 December 2016:

		2017			2016	
	Owner-Occupier	**Buy-to-let**	**Total**	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Less than 50%	**1,289**	**2**	**1,291**	1,065	1	1,066
50% - 70%	**1,125**	**2**	**1,127**	1,017	2	1,019
71% - 80%	**525**	**1**	**526**	548	2	550
81% - 90%	**508**	**2**	**510**	497	1	498
91% - 100%	**425**	**2**	**427**	507	2	509
101% - 120%	**616**	**2**	**618**	811	4	815
121% - 150%	**158**	**-**	**158**	553	2	555
Greater than 150%	**63**	**-**	**63**	115	1	116
Unsecured (Zero Collateral)	**19**	**1**	**20**	37	2	39
Total	**4,728**	**12**	**4,740**	5,150	17	5,167
Weighted average indexed LTV[1]						
Stock of residential mortgages at year end	**70%**	**78%**	**70%**	80%	95%	80%
New residential mortgages during year	**-**	**-**	**-**	-	-	-
Impaired mortgages	**102%**	**95%**	**102%**	109%	113%	109%

[1] Weighted average indexed LTV's are the individual indexed LTV calculations weighted by the mortgage balance against each property.

18% of the total owner-occupier and 25% of the total buy-to-let mortgages were in negative equity at 31 December 2017, compared to 29% and 53% respectively at 31 December 2016. The weighted average indexed loan-to-value for the total residential mortgage book was 70% at 31 December 2017 compared to 80% at 31 December 2016, with the reduction driven primarily by the increase in property prices in 2017, coupled with amortisation of the loan book and restructuring activity.

Risk Management Report (continued)

3.1 Credit risk (continued)

Actual and average LTV across mortgage portfolios (continued)

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

	2017			2016		
	Owner-Occupier	**Buy-to-let**	**Total**	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Less than 50%	**1,194**	**1**	**1,195**	985	1	986
50% - 70%	**1,009**	**2**	**1,011**	913	1	914
71% - 80%	**455**	**1**	**456**	476	1	477
81% - 90%	**440**	**2**	**442**	427	1	428
91% - 100%	**357**	**1**	**358**	440	1	441
101% - 120%	**476**	**-**	**476**	655	2	657
121% - 150%	**29**	**-**	**29**	346	1	347
Greater than 150%	**1**	**-**	**1**	3	-	3
Unsecured (Zero Collateral)	**2**	**-**	**2**	1	-	1
Total	**3,963**	**7**	**3,970**	4,246	8	4,254

The proportion of residential mortgages that were neither past due nor impaired and in negative equity at 31 December 2017 decreased in comparison to 31 December 2016, reflecting the increases in residential property prices in the period, coupled with amortisation of the loan book. 12.8% of residential mortgages that were neither past due nor impaired were in negative equity at 31 December 2017 compared to 23.7% at 31 December 2016.

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

	2017			2016		
	Owner-Occupier	**Buy-to-let**	**Total**	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Less than 50%	**38**	**-**	**38**	27	-	27
50% - 70%	**43**	**-**	**43**	34	-	34
71% - 80%	**22**	**-**	**22**	21	-	21
81% - 90%	**16**	**-**	**16**	16	-	16
91% - 100%	**12**	**-**	**12**	16	-	16
101% - 120%	**25**	**1**	**26**	25	-	25
121% - 150%	**5**	**-**	**5**	20	-	20
Greater than 150%	**-**	**-**	**-**	-	-	-
Unsecured (Zero Collateral)	**-**	**-**	**-**	1	-	1
Total	**161**	**1**	**162**	160	-	160

Of the residential mortgages that were past due but not impaired at 31 December 2017, 19% were in negative equity compared to 29% at 31 December 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 (continued)

Greater than 90 days past due and/or impaired*

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

	2017			2016		
	Owner-Occupier	**Buy-to-let**	**Total**	Owner-Occupier	Buy-to-let	Total
Loan-to-value (LTV) ratio	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Less than 50%	**57**	**-**	**57**	55	-	55
50% - 70%	**72**	**-**	**72**	70	-	70
71% - 80%	**49**	**-**	**49**	52	-	52
81% - 90%	**51**	**-**	**51**	54	-	54
91% - 100%	**56**	**-**	**56**	51	1	52
101% - 120%	**115**	**2**	**117**	131	2	133
121% - 150%	**125**	**-**	**125**	187	1	188
Greater than 150%	**62**	**-**	**62**	112	1	113
Unsecured (Zero Collateral)	**18**	**1**	**19**	34	2	36
Total	**605**	**3**	**608**	746	7	753

The proportion of residential mortgages that were greater than 90 days past due and/or impaired and in negative equity at 31 December 2017 (53%) decreased in comparison to 31 December 2016 (62%).

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

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Residential Mortgages by year of origination*

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

				2017
	Mortgage portfolio		**Impaired mortgage portfolio**	
	Number	**Balance €m**	**Number**	**Balance €m**
1996 and before	**1,189**	**42**	**77**	**4**
1997	**372**	**12**	**33**	**1**
1998	**695**	**16**	**40**	**2**
1999	**805**	**25**	**37**	**2**
2000	**1,025**	**48**	**65**	**5**
2001	**1,326**	**83**	**82**	**8**
2002	**1,859**	**141**	**105**	**10**
2003	**2,170**	**157**	**151**	**14**
2004	**2,529**	**216**	**183**	**20**
2005	**3,769**	**360**	**301**	**46**
2006	**6,594**	**887**	**700**	**130**
2007	**6,325**	**927**	**952**	**176**
2008	**5,974**	**813**	**748**	**125**
2009	**3,746**	**467**	**276**	**41**
2010	**3,737**	**505**	**147**	**22**
2011	**334**	**41**	**10**	**2**
2012	**-**	**-**	**-**	**-**
2013	**-**	**-**	**-**	**-**
2014	**-**	**-**	**-**	**-**
2015	**-**	**-**	**-**	**-**
2016	**-**	**-**	**-**	**-**
2017	**-**	**-**	**-**	**-**
Total	**42,449**	**4,740**	**3,907**	**608**

				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	-	-	-	-
Total	45,701	5,167	4,800	753

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.1 Credit risk (continued)

Residential Mortgages by year of origination* (continued)
The majority (€3.0bn or 63%) of the €4.7bn residential mortgage portfolio was originated between 2005 and 2008, of which 16% (€0.5bn) was impaired at 31 December 2017. This cohort was impacted by reduced household income and increased unemployment rates in those years, and where property prices had decreased from a peak in 2007. 16% of the residential mortgage portfolio was originated before 2005 of which 9% was impaired at 31 December 2017, while the remaining 21% of the portfolio was originated since 2009 or after, of which 6% was impaired at 31 December 2017.

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

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

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

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

The Bank has reduced its impaired loans from €753m at December 2013 to €608m as at 31 December 2017. A significant element of this reduction was through a customer debt restructuring programme. The objective of this process is to assist customers that find themselves in financial difficulties, to deal with them sympathetically and to work with them constructively to explore appropriate solutions. By continuing to work together in this process, AIB and the customer can find a mutually acceptable and alternative way forward. This approach has, and will continue to, materially improve AIB's asset quality and lower its overall risk profile, and strengthen its solvency. AIB continues to have a relatively high level of problem or criticised loans, which are defined as loans requiring additional management attention over and above that normally required for the loan type. AIB has been proactive in managing its criticised loans through the restructuring process. All restructured loans are managed in line with AIB's overall credit management practices.

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

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

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

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

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

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

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.3 Funding and liquidity risk (continued)

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

- the issuance of Mortgage Asset Covered Securities in accordance with the Asset Covered Securities (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.

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 Group entities. The Bank does not actively seek customer deposits.

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

Risk identification and assessment

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

Risk management and mitigation

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

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

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

First line management of funding and liquidity risk consists of:

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

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

Risk Management Report (continued)

3.3 Funding and liquidity risk (continued)

Risk management and mitigation (continued)
AIB Internal Audit provides third line assurance on Funding and Liquidity Risk.

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

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

Liquidity risk stress testing
Stress testing is a key component of the liquidity risk management framework and ILAAP. The Bank as part of AIB undertakes liquidity 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 AIB's liquidity buffer and liquidity risk drivers. The purpose of these tests is to ensure the continued stability of the liquidity position, within the AIB's pre-defined liquidity risk tolerance levels.

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

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

						2017
	Repayable on demand	**3 months or less but not repayable on demand**	**1 year or less but over 3 months**	**5 years or less but over 1 year**	**Over 5 years**	**Total**
	€ m	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**
Deposits by Banks	**-**	**1,723**	**-**	**-**	**-**	**1,723**
Derivative financial instruments	**-**	**-**	**-**	**-**	**20**	**20**
Debt securities in issue	**-**	**-**	**-**	**1,000**	**1,022**	**2,022**
Total	**-**	**1,723**	**-**	**1,000**	**1,042**	**3,765**

						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
Total	-	2,674	-	500	1,018	4,192

*Forms an integral part of the audited financial statements.

3.3 Funding and liquidity risk (continued)

Encumbrance

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

The Bank had an encumbrance ratio of 52% at 31 December 2017 (2016: 41%). 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 the Bank or AIB breaches or may breach regulatory capital ratios and internal targets. The key material risks impacting on the capital adequacy position of the Bank or AIB is credit risk, although it should be noted that all material risks can to some degree impact capital ratios.

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

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

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

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

*Forms an integral part of the audited financial statements.

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.

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

The Bank is not allowed to engage in proprietary trading under the conditions of the Asset Covered Securities Act and its license. The interest rate exposure of the Bank relating to its Irish residential lending is managed using two macro interest rate swaps with AIB one of which, the Pool Hedge, relates only to the Pool and Mortgage Covered Securities issued by the Bank and the other of which (the Non-Pool Hedge) relates only to Irish residential loans which are not included in the Pool. This split is required by the Asset Covered Securities Acts.

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

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

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

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.5 Market risk* (continued)

Interest Rate Exposure and Sensitivity*

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

	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
Assets	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**
Loans and receivables to customers	4,179	32	243	68	132	46	34	5	(289)	4,450
Loans and receivables to banks	69	-	-	-	-	-	-	-	-	69
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	20	20
Other assets	-	-	-	-	-	-	-	-	2	2
Total Assets	4,248	32	243	68	132	46	34	5	(267)	4,541
Liabilities										
Deposits by banks	1,723	-	-	-	-	-	-	-	-	1,723
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	20	20
Debt issued	2,022	-	-	-	-	-	-	-	-	2,022
Other liabilities	-	-	-	-	-	-	-	-	3	3
Shareholders' equity	-	-	-	-	-	-	-	-	773	773
Total Liabilities	3,745	-	-	-	-	-	-	-	796	4,541
Derivatives financial instruments										
(interest rate swaps)										
Floating rate interest receivable	(4,834)	-	-	-	-	-	-	-	-	(4,834)
Floating rate interest payable	4,274	32	243	68	132	46	34	5	-	4,834
Total derivatives	(561)	32	243	68	132	46	34	5	-	-
Interest sensitivity gap	(1,064)	-	-	-	-	-	-	-	(1,064)	
Cumulative interest sensitivity gap	1,064	1,064	1,064	1,064	1,064	1,064	1,064	1,064	-	

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 2017 would be circa -€6m/€6m 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 2016 analysed by the earlier of the repricing and the contractual maturity date is illustrated in the following table:

	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
Assets	€ 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
Total Assets	4,859	20	108	79	29	58	47	17	(264)	4,953
Liabilities										
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
Total Liabilities	4,174	-	-	-	-	-	-	-	779	4,953
Derivatives financial instruments (interest rate swaps)										
Floating rate interest receivable	(5,285)	-	-	-	-	-	-	-	-	(5,285)
Floating rate interest payable	4,927	20	108	79	29	58	47	17	-	5,285
Total derivatives	(358)	20	108	79	29	58	47	17	-	-
Interest sensitivity gap	1,043	-	-	-	-	-	-	-	(1,043)	
Cumulative interest sensitivity gap	1,043	1,043	1,043	1,043	1,043	1,043	1,043	1,043	-	

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 circa -€2m/€3m 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 the Bank and AIB actively seek to mitigate against.

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

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

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

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

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

3.7 Regulatory compliance risk including conduct risk*

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

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

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

Conduct Risk is defined as the risk that inappropriate actions, or inaction, by AIB cause poor and unfair outcomes for its customers or market instability. A mature Conduct Risk Framework, aligned with AIB Strategy, is embedded in the organisation and provides oversight of conduct risks at AIB Leadership Team and AIB 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.

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.7 Regulatory compliance risk including conduct risk* (continued)

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

3.8 People and culture risk*

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

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

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

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

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

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

3.9 Business model risk*

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

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

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

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

*Forms an integral part of the audited financial statements.

Risk Management Report (continued)

3.9 Business model risk* (continued)

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

3.10 Model risk*

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

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

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

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

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

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

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

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

*Forms an integral part of the audited financial statements.

Directors' Responsibility Statement

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

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

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

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

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

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

On behalf of the Board,

Denis Holland	Chris Curley
Chairman	Managing Director

23 March 2018

Independent Auditors’ Report to the Members of EBS Mortgage Finance

Report on the audit of the financial statements

Opinion on the financial statements of EBS Mortgage Finance (the ‘Company’)
In our opinion the Company financial statements:

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

The financial statements we have audited comprise:

- the Income Statement;
- the Statement of Comprehensive Income;
- the Statement of Financial Position;
- the Statement of Cash Flows;
- the Statement of Changes in Shareholders’ Equity; and
- the related notes 1 to 26, including a summary of significant accounting policies as set out in note 1.

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

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

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

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

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year was: – Loan impairment and restructuring.
Materiality	We determined materiality for the Company to be €10m which is approximately 7% of profit before tax excluding Group Charges payable to EBS d.a.c. (note 7) (‘Materiality Benchmark’).
Significant changes in our approach	There were no significant changes in our approach which we feel require disclosure.

Conclusions relating to going concern

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

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

Independent Auditors’ Report to the Members of EBS Mortgage Finance

Key audit matters

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

Loan impairment and loan restructuring	
Key audit matter description	There is a risk that provisions for impairment of loans and receivables of €290m (2016: €287m) do not represent an appropriate estimate of the losses incurred. This includes the risk that the estimate of cashflows on restructuring cases is not appropriately measured. The determination of appropriate provisions requires a significant amount of management judgment over key assumptions and relies on available data. The Company has disclosed in note 1.17, as required by IAS 8, estimated information regarding the possible transition effect of the adoption of IFRS 9 from 1 January 2018. Please also refer to page 63 (Accounting Policy 1.9 – Impairment of financial assets), Note 2 – Critical accounting judgements and estimates and Note 8 - Impairment of loans and receivables.
How the scope of our audit responded to the key audit matter	We undertook an assessment of the provisioning practices to compare them with the requirements of IFRS. We evaluated the design and tested the operating effectiveness of controls over: • impairment identification and calculation; • credit management processes; • new lending; • restructuring transactions; • front line credit monitoring and assessment; • collective and latent impairment models, including source data controls and calculations; and • the work of the credit review function. Our testing of controls included an evaluation of IT system controls, management review controls and governance controls. In examining both sample loan cases and models, we challenged management on the judgments made regarding the application of triggers, status of restructures, collateral valuation and realisation time frames; and examined the credit risk functions analysis of data at a portfolio level. We tested samples of the data used in the models, management adjustments, together with the calculations involved and the output from the models. Where appropriate, this work involved assessing third party valuations of collateral, internal valuation guidelines derived from benchmark data, external expert reports on borrowers’ business plans and enterprise valuations. This allowed us to determine whether appropriate valuation methodologies were employed and assess the objectivity of the external experts used. We evaluated the disclosures made in the financial statements. In particular, we focused on challenging management that the disclosures were sufficiently clear in highlighting the significant uncertainties that exist in respect of loan impairment provisioning and the sensitivity of the provisions to changes in the underlying assumptions. We have examined the disclosure required under IAS 8 of the estimated transition effect of IFRS 9. Based on the evidence obtained, we found that the data and assumptions used by management in loan impairment provisioning are within a range we consider to be reasonable.

Independent Auditors' Report to the Members of EBS Mortgage Finance (continued)

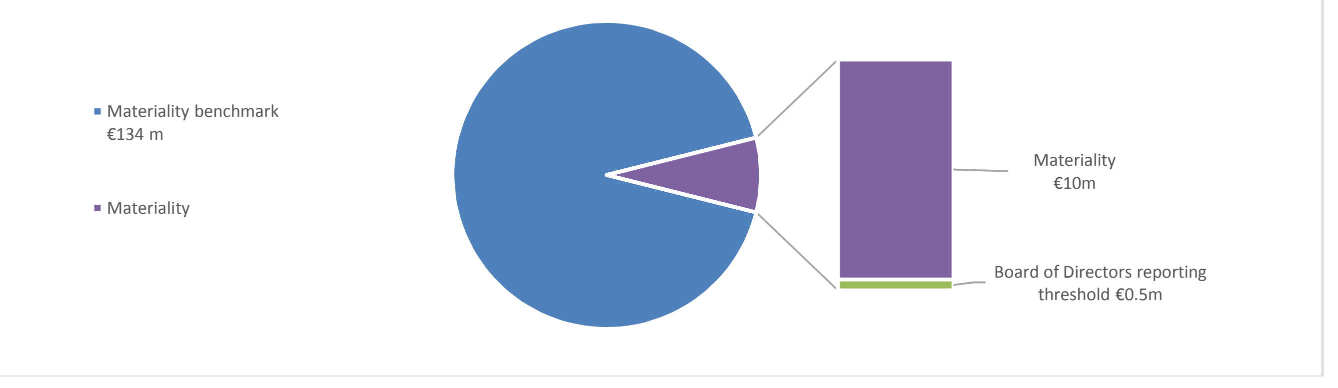
Key audit matters (continued)

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

Our application of materiality

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

We determined materiality for the Company to be €10m which is 7% of profit before tax excluding amounts payable to EBS d.a.c. (note 7) ('Materiality Benchmark'). We have considered the Materiality Benchmark to be the critical component for determining materiality. We used this measure as the best measure for assessing financial performance and in order to reduce the potential for volatility in materiality year-on year. This is a generally accepted auditing practice. We have considered quantitative and qualitative factors such as understanding the entity and its environment, history of misstatements, complexity of the company and the reliability of control environment.



We agreed with the Board of Directors that we would report to them any audit differences in excess of €0.5 million, as well as differences below that threshold which, in our view, warranted reporting on qualitative grounds. We also report to the Board of Directors on disclosure matters that we identified when assessing the overall presentation of the financial statements.

An overview of the scope of our audit

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

Other information

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

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

We have nothing to report in this regard.

Independent Auditors’ Report to the Members of EBS Mortgage Finance (continued)

Responsibilities of the directors

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

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

Auditor’s responsibilities for the audit of the financial statements

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

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

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the directors.

- Conclude on the appropriateness of the directors’ use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Company’s ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor’s report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of the auditor’s report. However, future events or conditions may cause the entity (or where relevant, the Company) to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

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

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

Independent Auditors’ Report to the Members of EBS Mortgage Finance (continued)

Report on other legal and regulatory requirements

Opinion on other matters prescribed by the Companies Act 2014
Based solely on the work undertaken in the course of the audit, we report that:

- We have obtained all the information and explanations which we consider necessary for the purposes of our audit.

- In our opinion the accounting records of the Company were sufficient to permit the financial statements to be readily and properly audited.
- The Company Statement of Financial Position is in agreement with the accounting records.
- In our opinion the information given in the directors' report is consistent with the financial statements and the directors' report has been prepared in accordance with the Companies Act 2014.

Corporate Governance Statement

We report, in relation to information given in the Corporate Governance Statement on pages 3 to 4 that, in our opinion the information given in the Corporate Governance Statement pursuant to subsections 2(c) and (d) of section 1373 Companies Act 2014 is consistent with the company's statutory financial statements in respect of the financial year concerned and such information has been prepared in accordance with section 1373 of the Companies Act 2014.

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

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

Matters on which we are required to report by exception

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

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

Other matters which we are required to address

Following the recommendation from the Board of the Company, we were appointed at the Annual General Meeting on 30 June 2013 to audit the financial statements for the financial year ended 31 December 2013 and subsequent financial periods. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 5 years, covering the years ending 2013 to 2017.

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

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

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

Date:

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

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

Income Statement

For the financial year ended 31 December 2017

	Note	**2017**	2016
		€ m	€ m
Interest income and similar income	3	**180**	205
Interest expense and similar charges	4	**(15)**	(35)
Net interest income		**165**	170
Net trading income	5	**2**	3
Other operating income/(expense)	6	**1**	(10)
Total operating income		**168**	163
Administrative expenses	7	**(98)**	(5)
Operating profit before provisions		**70**	158
Provisions for impairment of loans and receivables	8	**(40)**	(20)
Operating profit before taxation		**30**	138
Income tax charge	9	**(4)**	(17)
Profit for the financial year		**26**	121

The operating profit arises from continuing operations.

Statement of Comprehensive Income

For the financial year ended 31 December 2017

	2017	2016
	€ m	€ m
Profit for the financial year	**26**	121
Other comprehensive income for the financial year	**-**	-
Total comprehensive income for the financial year	**26**	121

The notes on pages 58 to 90 are an integral part of these financial statements.

Statement of Financial Position

As at 31 December 2017

	Note	**2017 € m**	2016 € m
Assets			
Non-current asset held for sale	10	**1**	2
Derivative financial instruments	11	**20**	19
Loans and receivables to banks	12	**69**	49
Loans and receivables to customers	13	**4,450**	4,880
Current taxation		**-**	3
Prepayments and accrued income		**1**	-
Total assets		**4,541**	4,953
Liabilities			
Deposits by banks	14	**1,723**	2,674
Derivative financial instruments	11	**20**	18
Debt securities in issue	15	**2,022**	1,500
Provisions for liabilities and commitments	16	**1**	14
Other liabilities		**2**	-
Total liabilities		**3,768**	4,206
Shareholders' equity			
Issued share capital presented as equity	17	**552**	552
Revenue reserves		**221**	195
Shareholders' equity		**773**	747
Total liabilities and shareholders' equity		**4,541**	4,953

The notes on pages 58 to 90 are an integral part of these financial statements.

Denis Holland
Chairman

Chris Curley
Managing Director

Niamh Carolan
AIB Group Non-Executive Director

Cara Teahan
Secretary

23 March 2018

Statement of Cash Flows

For the financial year ended 31 December 2017

	Note	2017 € m	2016 € m
Cash flows from operating activities			
Operating profit before taxation		**30**	138
Amortisation of fair value discount on debt securities in issue	4	**-**	9
Impairment of loans and receivables	8	**40**	20
Fair value movement on trading item		**1**	(1)
		71	166
Changes in operating assets and liabilities			
Change in loans and receivables to customers	13	**390**	365
Change in accrual and deferred income		**-**	(1)
Change in provisions for liabilities and commitments	16	**(13)**	(21)
Change in other assets		**1**	-
Change in other liabilities		**-**	1
Net cash flows from operations before taxation		**449**	510
Taxation paid		**-**	(28)
Net cash flows from operations		**449**	482
Net cash flow from investing activities		**-**	-
Cash flow from financing activities			
Loss on repurchase of debt securities in issue	15	**-**	10
Issue/(redemption) of debt securities		**522**	(906)
Change in deposits by banks	14	**(951)**	403
Net cash flows from financing activities		**(429)**	(493)
Net decrease in cash and cash equivalents		**20**	(11)
Cash and cash equivalents at 1 January		**49**	60
Cash and cash equivalents at 31 December	19	**69**	49

The notes on pages 58 to 90 are an integral part of these financial statements.

Statement of Changes in Shareholders' Equity

For the financial year ended 31 December 2017

	Ordinary Share Capital	Revenue Reserves	Total Shareholders' Equity
	€ m	€ m	€ m
At 1 January 2017	**552**	**195**	**747**
Total comprehensive income for the financial year	**-**	**26**	**26**
At 31 December 2017	**552**	**221**	**773**

At 1 January 2016	552	74	626
Total comprehensive income for the financial year	-	121	121
At 31 December 2016	552	195	747

Notes to the Financial Statements

Notes to the Financial Statements (continued)

ACCOUNTING POLICIES INDEX

1.1 Reporting entity

1.2 Statement of compliance

1.3 Basis of preparation

1.4 Interest income and expense recognition

1.5 Net trading income

1.6 Financial assets

1.7 Financial liabilities

1.8 Derivatives and hedge accounting

1.9 Impairment of financial assets

1.10 Non-credit risk provisions

1.11 Income tax, including deferred tax

1.12 Cash and cash equivalents

1.13 Shareholders' equity

1.14 Determination of fair value of financial instruments

1.15 Non-current asset held for sale

1.16 Foreign currency translation

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 2017 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's registered office is The EBS Building, 2 Burlington Road, Dublin 4, and it is registered under company number 463791. The Bank is a wholly owned subsidiary of EBS Designated Activity Company ("EBS"), which is included as part of EBS Group (the 'Group') and AIB Group plc and is regulated by the Single Supervisory Mechanism ('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 2017. The accounting policies have been consistently applied by the Bank and are consistent with the previous year, unless otherwise described. The financial statements also comply with the Companies Act 2014 applicable to companies reporting under IFRS and the European Communities (Credit Institutions: Financial Statements) Regulations, 2016 (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 and 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 Report 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 2017 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment. The period of assessment used by the Directors is twelve months from the date of approval of these annual financial statements.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.3. Basis of preparation (continued)

Going concern **(continued)**
The Bank is dependent on its parent EBS for continued funding and is therefore dependent on the going concern status of the parent. EBS is dependent on its parent AIB for continued funding and is therefore dependent on the going concern status of the parent.

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

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

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

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

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

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

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

Adoption of new accounting standards
During the year to 31 December 2017, the Bank 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.

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 the Bank 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 accounting policy number 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’).

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.8. Derivatives and hedge accounting (continued)

Hedging (continued)

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.

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.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.9. Impairment of financial assets (continued)

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

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

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

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

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

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and the historical loss experience for assets with credit risk characteristics similar to those in 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.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.9. Impairment of financial assets (continued)

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

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

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

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

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

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

Where a loan has been subject to an impairment provision and the renegotiation leads to a customer granting equity to the Bank 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.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.9. Impairment of financial assets (continued)

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

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

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

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.

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.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

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

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

Dividends and distributions
Dividends on ordinary shares are recognised in equity in the period in which they are approved by the 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 Bank has access at that date. The Bank considers the impact of non-performance risk when valuing its financial liabilities.

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

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

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

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

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

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.14 Determination of fair value of financial instruments (continued)

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

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

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

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

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 inputs, estimates are made to reflect uncertainties in fair values resulting from a lack of market data, for example, as a result of illiquidity in the market. For these instruments, the fair value measurement is less reliable. Inputs into valuations based on non-observable data are inherently uncertain because there is little or no current market data available from which to determine the price at which an orderly transaction between market participants would occur under current market conditions. However, in most cases there is some market data available on which to base a determination of fair value, for example historical data, and the fair values of most financial instruments will be based on some market observable inputs even where the non-observable inputs are significant. All unobservable inputs used in valuation techniques reflect the assumptions market participants would use when fair valuing the financial instrument.

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

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

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

1.15. Non-current 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.

1. ACCOUNTING POLICIES (continued)

1.15. Non-current asset held for sale (continued)

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 off 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.

Non-current assets held for sale are presented separately on the statement of financial position. Prior periods are not reclassified.

1.16. Foreign currency translation

Items included in the financial statements of the Bank 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. The Bank is currently considering the impacts of these amendments. The new accounting standards and amendments which are more relevant to the Bank are detailed below:

(a) Annual improvements to cycles/other

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

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

(b) IFRIC 23 Uncertainty over Income Tax Treatments

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

The Interpretation specifically addresses the following:

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

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

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

1. ACCOUNTING POLICIES (continued)

1.17. Prospective accounting changes (continued)

(c) IFRS 15 Revenue from Contracts with Customers

IFRS 15, which was issued in May 2014, replaces IAS 11 *Construction Contracts* and IAS 18 *Revenue* in addition to IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31.

IFRS 15 specifies how and when an entity recognises revenue from a contract with a customer through the application of a single, principles based five-step model. The standard specifies new qualitative and quantitative disclosure requirements to enable users of financial statements understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

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

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

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

(d) IFRS 16 Leases

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

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

IFRS 16 is expected to have no impact on the financial statements.

(e) IFRS 9 Financial Instruments

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

Classification and measurement

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

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.17. Prospective accounting changes (continued)

(e) IFRS 9 Financial Instruments (continued)

Impairment

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

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

Set out below is a summary of the impacts of IFRS 9 together with policy choices selected by AIB where relevant:

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

In general:
- loans and advances to banks and customers that are currently classified as 'loans and advances' under IAS 39 will be measured at amortised cost under IFRS 9;
- debt securities classified as available for sale under IAS 39 will be measured at fair value through other comprehensive income; and
- debt securities classified as 'held to maturity' under IAS 39 will be measured at amortised cost.

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

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

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

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

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

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.17. Prospective accounting changes (continued)

(e) IFRS 9 Financial Instruments (continued)

Impairment

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

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

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

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

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

Models have been developed for:

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

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

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

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

Hedge accounting

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

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.17. Prospective accounting changes (continued)

(e) IFRS 9 Financial Instruments (continued)

Disclosures/other
A significant suite of reporting requirements have been 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 have been aligned so as to assist comparability. In addition, a suite of transitional disclosure templates have been prepared and will be populated and published as relevant during 2018.

Briefings to the business and various stakeholders throughout the AIB Group have taken place and will continue for 2018 and beyond.

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

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

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

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

Based on assessments undertaken to date, the total estimate of the possible impact net of tax on transition is €56m representing an increase in revenue reserves and other comprehensive income.

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

IASB effective date Annual periods beginning on or after 1 January 2018.

2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

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

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

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

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

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

2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

(a) Going concern (continued)

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

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

(b) Loan impairment

The Bank's accounting policy for impairment of financial assets is set out in note 1.9. The provisions for impairment on loans and receivables at 31 December 2017 represent management's best estimate of the losses incurred in the loan portfolios at the reporting date. The estimation of loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local economic climate, conditions in various industries to which 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 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 AIB Board approval being sought.

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

Specific 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 pages 20 to 22 of the Risk Management Report.

Incurred but not reported provisions

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

The total amount of impairment loss in the Bank's non-impaired portfolio, and therefore the adequacy of the IBNR provision is inherently uncertain. There may be factors in the portfolio that have not been a feature of the past and changes in credit grading profiles and grading movements may lag the change in the credit profile of the customer. In addition, current estimates of loss within the non-impaired portfolio and the period of time it takes following a loss event for an individual loan to be recognised as impaired ('emergence period') are subject to a greater element of estimation due to the speed of change in the economies in which the Group operates. For further details please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on pages 20 and 22 of the Risk Management Report.

2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

(b) Loan impairment (continued)

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 Report.

(c) Fair value of financial instruments

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

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

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

(d) Provisions for liabilities and commitments

The Bank's accounting policy for provisions for liabilities and commitments is set out in note 1.10 'Non-credit risk provisions' in note 1.

The Bank 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 16 to the financial statements.

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

Notes to the Financial Statements (continued)

3. INTEREST INCOME AND SIMILAR INCOME

	2017 € m	2016 € m
Interest on loans and receivables to customers	**147**	162
Amortisation of fair value discount on loans and receivables to customers	**33**	43
	180	205

Included within various captions under interest income for the financial year ended 31 December 2017 is a total of €12m (2016: €16m) accrued on impaired financial assets.

4. INTEREST EXPENSE AND SIMILAR CHARGES

	2017 € m	2016 € m
Interest payable to credit institutions	**13**	16
Interest on debt securities in issue	**2**	10
Amortisation of fair value discount on debt securities in issue	**-**	9
	15	35

5. NET TRADING INCOME

	2017 € m	2016 € m
Debt Securities and interest rate contracts	**2**	3
	2	3

6. OTHER OPERATING INCOME/EXPENSE

	2017 € m	2016 € m
Loss on repurchase of debt securities in issue	**-**	(10)
Miscellaneous operating income	**1**	-
	1	(10)

Notes to the Financial Statements (continued)

7. ADMINISTRATIVE EXPENSES

	2017	2016
	€ m	€ m
Other administrative expenses	**(6)**	(11)
Amounts payable to EBS	**104**	16
	98	5

In 2017, a review was completed of pricing arrangements between AIB and the Bank. Arising from this review, a new pricing agreement was signed and implemented during 2017. The new agreement reflects OECD guidelines on transfer pricing which are the internationally accepted principles in this area, and take account of the functions, risks and assets involved. Amounts payable to EBS increased to €104m from €16m following the implementation of revised transfer pricing arrangements for 2017 which resulted in additional cost allocations for credit management, central control function costs, risks borne and assets provided by EBS.

Other administrative expenses consists of statutory payments (regulatory payments/levies) €3.2m (2016: €3.5m), professional fees €0.5m (2016: €0.6m) and writeback for provisions for liabilities & commitments €9.7m which related to customer redress and other costs (2016: €15.0m). See also note 16 provisions for liabilities and commitments.

There were no full time equivalents employed by the Bank in the financial year 2017 (2016: Nil), monthly average Nil.

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

Auditors' remuneration (excluding VAT)

	2017	2016
	€ '000	€ '000
Statutory Audit of entity financial statements	**13**	13
Other assurance services	**-**	-
Tax advisory services	**-**	-
Other non-audit services	**-**	10
Total auditors' remuneration	**13**	23

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 Bank's Auditor (Deloitte) for services to the Bank only be disclosed in this format. Other assurance services include fees for additional assurance issued by the firm outside of the audit of the statutory financial statements. These fees include assignments where the auditor provides assurance to third parties.

The remuneration of the Non-Executive Directors in office during 2017 is as follows:

	2017	2016
	€ '000	€ '000
Fees	**32**	30
	32	30

No additional remuneration has been made to any individuals employed directly by AIB for roles discharged as directors of the Bank. 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 (2016: Nil) to persons connected with a director in accordance with Section 306(1) of the Companies Act 2014.

8. IMPAIRMENT OF LOANS AND RECEIVABLES

	2017			2016		
	Specific	**IBNR**	**Total**	Specific	IBNR	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Balance at start of year	**258**	**29**	**287**	253	28	281
Charge against income statement	**22**	**18**	**40**	19	1	20
Amounts written off	**(37)**	**-**	**(37)**	(14)	-	(14)
Balance at end of year	**243**	**47**	**290**	258	29	287

By geographical location and industry sector	**2017**	2016
	€ m	€ m
Republic of Ireland		
Home Mortgages	**290**	287

9. TAXATION

	2017	2016
	€ m	€ m
Current tax charge on income for financial year	**(4)**	(17)
Total tax charge for the financial year	**(4)**	(17)

The tax charge (2016: charge) for the financial year is at an effective rate of 12.5%, which is the same as the standard Irish corporation tax rate.

	2017		2016	
	€ m	%	€ m	%
Operating profit before taxation	**30**		138	
Corporation tax charge (12.5%)	**(4)**	**12.5**	(17)	12.5
Tax charge	**(4)**	**12.5**	(17)	12.5

10. NON-CURRENT ASSETS HELD FOR SALE

	2017	2016
	€ m	€ m
Repossessed assets	**1**	2
	1	2

11. DERIVATIVE FINANCIAL INSTRUMENTS

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

	2017			2016		
	Contract/ Notional	**Fair Value Asset**	**Fair Value Liability**	Contract/ Notional	Fair Asset	Fair Value Liability
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Derivatives classified as trading						
Interest rate swaps	**4,834**	**20**	**20**	5,285	19	18
Total derivatives	**4,834**	**20**	**20**	5,285	19	18

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

	Residual Maturity 2017				Residual Maturity 2016			
	Within	**1 to 5 yrs**	**Over 5**	**Total**	Within	1 to 5 yrs	Over 5	Total
	€ m	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m	€ m
Underlying principal amount	**-**	**-**	**4,834**	**4,834**	-	137	5,148	5,285
Positive fair value								
Interest rate contracts	**-**	**-**	**20**	**20**	-	2	17	19

12. LOANS AND RECEIVABLES TO BANKS

	2017	2016
	€ m	€ m
Funds placed with EBS		
Analysed by remaining maturity:		
3 months or less	**56**	30
Funds placed with other banks outside AIB		
Analysed by remaining maturity:		
3 months or less	**13**	19
	69	49

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 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 December 2017, the Bank's credit rating with Moody's was Aaa. At 31 December 2017, 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

	2017 € m	2016 € m
Analysed by remaining maturity:		
Repayable on demand	**590**	709
3 months or less	**-**	-
1 year or less but over 3 months	**2**	2
5 years or less but over 1 year	**85**	87
Greater than 5 years	**4,063**	4,369
	4,740	5,167
Provision for impairment of loans and receivables (Note 8)	**(290)**	(287)
	4,450	4,880

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

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.

Interest recognised on impaired loans amounted to €12m (2016: €16m) and is included in the carrying value of loans and receivables to customers. This has been credited to interest income.

By geographic location and sector	2017 € m	2016 € m
Republic of Ireland		
Home mortgages (net of impairment provisions)	**4,450**	4,880
	4,450	4,880

14. DEPOSITS BY BANKS

	2017 € m	2016 € m
Funds received from EBS	**1,723**	2,674
	1,723	2,674

The facility limit with EBS is €4.0bn and the balance at 31 December 2017 amounted to €1.7bn (2016: €2.7bn). 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.

Notes to the Financial Statements (continued)

15. DEBT SECURITIES IN ISSUE

	2017 € m	2016 € m
Mortgage covered securities in issue by remaining maturity:		
3 months or less	**-**	-
1 year or less but over 3 months	**-**	-
5 years or less but over 1 year	**1,000**	500
Greater than 5 years	**1,022**	1,000
Carrying value of Debt Securities	**2,022**	1,500
Mortgage covered securities to internal issuances at nominal value:		
EBS	**2,022**	1,500
	2,022	1,500

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

At 31 December 2017, the Cover Assets Pool amounted to €3.78bn (2016: €3.88bn), comprising of €3.77bn (2016: €3.86bn) of mortgage credit assets (mortgage loan accounts) and €0.01bn (2016: €0.02bn) of substitution assets (cash on deposit with suitably rated credit institutions). Section 40(2) of the Act requires that the following information be disclosed in respect of mortgage credit assets that are recorded in the register of mortgage covered securities business.

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

Total Loan Balances

From	To	Total Loan 2017 (1 & 2) € m	Number of 2017	Total Loan 2016 (1 & 2) € m	Number of 2016
€0	€100,000	**503**	**10,640**	513	11,046
€100,000	€200,000	**1,604**	**10,756**	1,634	10,952
€200,000	€500,000	**1,581**	**6,133**	1,618	6,280
Over €500,000		**79**	**118**	97	144
		3,767	**27,647**	3,862	28,422

[(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 34,998 loan accounts (2016: 36,351) secured on 27,647 properties (2016: 28,422).

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

Geographical Area	Number of Mortgaged Properties 2017		Number of Mortgaged Properties 2016	
Co. Dublin	**9,886**	**36%**	9,966	35%
Outside Co. Dublin	**17,761**	**64%**	18,456	65%
	27,647	**100%**	28,422	100%

Notes to the Financial Statements (continued)

15. DEBT SECURITIES IN ISSUE (continued)

(c) Mortgage loan accounts in default in the Cover Assets Pool with arrears greater than or equal to three months
As at 31 December 2017, there were 75 mortgage loan accounts (2016: 38) 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 2017, 1,121 mortgage loan accounts (2016: 1,299) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2017, there were 347 accounts in default in the Cover Assets Pool (2016: 278).

(e) Replacement of non-performing mortgage loan accounts from the Cover Assets Pool
During the year ended 31 December 2017, 108 non-performing mortgage loan accounts (2016: 176) 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 2017 as the Cover Assets Pool continued to meet all regulatory requirements. However, in June 2017 1,563 loans were transferred into the Cover Assets Pool from the Non-pool.

(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 942 accounts (2016: 894) as at 31 December 2017 was €0.48m (2016: €0.43m).

(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 financial year ended 31 December 2017 was €468m (2016: €459m), of which €353m (2016: €336m) represented repayment of principal and €115m (2016: €123m) 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 2017 there were no loan accounts (2016: Nil) in the Cover Assets Pool that were secured on commercial properties.

16. PROVISIONS FOR LIABILITIES AND COMMITMENTS

	2017
	€ m
At 1 January 2017	**14**
Amounts charged to income statement	**-**
Amounts written back to income statement	**(10)**
Provisions utilised	**(3)**
At 31 December 2017[(1)]	**1**

	2016
	€ m
At 1 January 2016	35
Amounts charged to income statement	-
Amounts written back to income statement	(15)
Provisions utilised	(6)
At 31 December 2016[(1)]	14

(1) The total provisions for liabilities and commitments expected to be settled within one year amount to €1m (2016: €14m).

16. PROVISIONS FOR LIABILITIES AND COMMITMENTS

Provisions for customer redress and other costs

In 2015, the Bank created a provision of €21m related to the expected outflow for customer redress and compensation in respect of tracker mortgages where rates given to customers were either not in accordance with original contract terms or where the transparency of terms did not conform to that which a customer could reasonably expect (Tracker Mortgage Examination). Over the past two years over 150 customers were redressed and compensated. Over the past two years €16m was written back to the income statement, and the remaining provision for customer redress and compensation of €5m was fully utilised at 31 December 2017.

The final redress and compensation is subject to independent third party assurance and is also subject to assessment and challenge by the Central Bank, notwithstanding the advanced stage of the examination process in the Bank.

In 2015, the Bank also created a provision of €14m with regard to 'Other costs'. €9m was written back to the income statement in 2017. Over the past two years €4m was utilised bringing the provision for 'Other costs' to €1m at 31 December 2017.

17. ISSUED SHARE CAPITAL PRESENTED AS EQUITY

	2017	2016
	€ m	€ m
Authorised:		
1,000,000,000 ordinary shares of €1.00 each	**1,000**	1,000
(2016: 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
(2016: 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.

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

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

19. STATEMENT OF CASH FLOWS

Analysis of Cash and Cash Equivalents

	2017	2016
	€ m	€ m
Loans and receivables to banks (note 12)	**69**	49
	69	49

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

20. SEGMENTAL INFORMATION

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

21. 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 note 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 2017.

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

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

Level 1 – financial assets and liabilities measured using quoted market prices from an active market (unadjusted).
Level 2 – financial assets and liabilities measured using valuation techniques which use quoted market prices from an active market or measured using quoted market prices unadjusted from an inactive market.
Level 3 – financial assets and liabilities measured using valuation techniques which use unobservable inputs.

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

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

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 AIB Finance function and validated by the AIB 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.

Notes to the Financial Statements (continued)

21. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

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.

The fair value of variable rate mortgage products including tracker mortgages is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in the portfolio. For fixed rate mortgages, the fair value is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in that portfolio. For the overall loan portfolio, an adjustment is made for credit risk which at 31 December 2017 took account of the Banks' expectations on credit losses over the life of the loans.

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

Debt securities in issue
The estimated fair value of 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)

21. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

2017

	Carrying amount in the statement of financial position				
	At fair value through profit and loss		At amortised cost		Total
	Held for trading	Fair value hedge derivatives	Loans and receivables	Other	
Financial assets measured at fair value	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**
Interest rate derivatives	**20**	**-**	**-**	**-**	**20**
Financial assets not measured at fair value					
Loans and receivables to banks	**-**	**-**	**69**	**-**	**69**
Loans and receivables to customers	**-**	**-**	**4,450**	**-**	**4,450**
	20	**-**	**4,519**	**-**	**4,539**
Financial liabilities measured at fair value					
Interest rate derivatives	**20**	**-**	**-**	**-**	**20**
Financial liabilities not measured at fair value					
Deposits by banks	**-**	**-**	**-**	**1,723**	**1,723**
Debt securities in issue	**-**	**-**	**-**	**2,022**	**2,022**
	20	**-**	**-**	**3,745**	**3,765**

2016

	Carrying amount in the statement of financial position				
	At fair value through profit and loss		At amortised cost		Total
	Held for trading	Fair value hedge derivatives	Loans and receivables	Other	
Financial assets measured at fair value	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**
Interest rate derivatives	19	-	-	-	19
Financial assets not measured at fair value					
Loans and receivables to banks	-	-	49	-	49
Loans and receivables to customers	-	-	4,880	-	4,880
	19	-	4,929	-	4,948
Financial liabilities measured at fair value					
Interest rate derivatives	18	-	-	-	18
Financial liabilities not measured at fair value					
Deposits by banks	-	-	-	2,674	2,674
Debt securities in issue	-	-	-	1,500	1,500
	18	-	-	4,174	4,192

21. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

2017

	Fair value hierarchy			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value	**€ m**	**€ m**	**€ m**	**€ m**
Interest rate derivatives	**-**	**20**	**-**	**20**
Financial assets not measured at fair value				
Loans and receivables to banks	**-**	**-**	**69**	**69**
Loans and receivables to customers	**-**	**-**	**4,303**	**4,303**
	-	**20**	**4,372**	**4,392**
Financial liabilities measured at fair value				
Interest rate derivatives	**-**	**20**	**-**	**20**
Financial liabilities not measured at fair value				
Deposits by banks	**-**	**-**	**1,723**	**1,723**
Debt securities in issue	**-**	**1,975**	**-**	**1,975**
	-	**1,995**	**1,723**	**3,718**

2016

	Fair value hierarchy			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value	**€ m**	**€ m**	**€ m**	**€ m**
Interest rate derivatives	-	19	-	19
Financial assets not measured at fair value				
Loans and receivables to banks	-	-	49	49
Loans and receivables to customers	-	-	4,696	4,696
	-	19	4,745	4,764
Financial liabilities measured at fair value				
Interest rate derivatives	-	18	-	18
Financial liabilities not measured at fair value				
Deposits by banks	-	-	2,674	2,674
Debt securities in issue	-	1,423	-	1,423
	-	1,441	2,674	4,115

Notes to the Financial Statements (continued)

22. RELATED PARTY TRANSACTIONS

The immediate holding company and controlling party is EBS d.a.c. ('EBS'), with a registered office at 2 Burlington Road, Dublin 4. The ultimate holding entity and controlling party is AIB Group plc. EBS is a wholly owned subsidiary of AIB which is a wholly owned subsidiary of AIB Group plc, with a registered office at Bankcentre, Ballsbridge, Dublin 4. Copies of both the Group and AIB financial statements are available from the registered office of AIB. The only related party transactions are normal banking transfers to and from EBS.

a) Transactions with EBS

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

The impact of implementing the new transfer pricing agreement which attributes an arm's length Return on Equity to the Bank of €26m, is an increase in Administrative expenses for 2017 of €88m, being the primary reason for the reduction in profit after tax to €26m (2016: €121m). The additional charge is in respect of credit management, central function costs, risks borne by and assets provided by AIB in facilitating the operations of the Bank.

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

- Loans from EBS at 31 December 2017 are €1,723m (2016: €2,674m).
- Deposits placed with EBS at 31 December 2017 are €56m (2016: €30m).
- The nominal value of debt securities in issue to EBS at 31 December 2017 are €2,022m (2016: €1,500m).

At 31 December 2017, there were no derivative transactions between the Bank and the ultimate parent, AIB.

	2017	2016
	€m	€m
Loans and receivables to banks	**56**	30
Deposits by banks	**1,723**	2,674
Included in the Income Statement		
Interest expense on loans	**(13)**	(16)
Administrative expenses	**(104)**	(16)
Derivative financial instruments		
Interest rate swaps		
Assets (Fair value)	**20**	19
Liabilities (Fair value)	**20**	18
Net Trading Income	**2**	3
Debt securities to EBS	**2,022**	1,500

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.

22. RELATED PARTY TRANSACTIONS (continued)

(b) IAS 24 Related Party Disclosures

The following disclosures are made in accordance with the provisions of IAS 24 Related Party Disclosures. Under IAS 24, Key Management Personnel are defined as comprising Executive, Non-Executive Directors, together with Senior Executive Officers. As at 31 December 2017 the Bank had 12 KMP (2016: 5 KMP).

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

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

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

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

There were no amounts outstanding in respect of loans, quasi loans and credit transactions between the Bank and the KMP, as defined above, together with members of their close families and entities influenced by them.

(c) Companies Act 2014 disclosures

(i) Loans to Directors

The following information is presented in accordance with the Companies Act 2014. For the purposes of the Companies Act disclosures, Director means the Board of Directors and any past Directors who are Directors during the relevant period. There were 8 Directors in office during the year, none of whom availed of credit facilities (2016: 0).

(ii) Connected persons

The aggregate of loans to connected persons of Directors in office at 31 December 2017, as defined in Section 220 of the Companies Act 2014, are as follows (aggregate of 1 person; 2016: 1):

	Balance at 31 December 2016	**Balance at 31 December 2017**
	€ 000	**€ 000**
Loan	154	**148**
Overdraft/Credit Card	-	**-**
Total	154	**148**
Interest Charged during 2017*	2	**2**
Maximum debit balance during 2017**	160	**154**

The 2016 comparatives have been updated to include additional data which had been omitted in error in the 2016 Annual Financial Report.

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

*Amounts advanced and repaid are not shown for overdraft/credit card facilities as these are revolving in nature (i.e. they may be drawn, repaid and redrawn up to their limit over the course of the year).
**The maximum debit balance is calculated by aggregating the maximum debit balance drawn on each facility during the year.

d) Summary of AIB relationship with the Irish Government

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

Ordinary Shares

At 31 December 2017, the State held 71.12% of the ordinary shares of AIB Group plc (31 December 2016: 99.9% of the ordinary shares of AIB).

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.

Notes to the Financial Statements (continued)

23. COMMITMENTS

At 31 December 2017 the Bank had €12m (2016: €10m) of approved mortgage loan applications that had not been drawn down as at the financial year end.

24. NON-ADJUSTING EVENTS AFTER REPORTING PERIOD

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

25. PARENT COMPANY

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

26. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on the 23 March 2018.