EBS MORTGAGE FINANCE

Directors' Report and

Annual Financial Statements

For the financial year ended 31 December 2018

Contents

Directors and Other Information

DIRECTORS	Helen Dooley	AIB Group Non-Executive Director and Chair
	Chris Curley	Executive Director (Managing Director)
	Brendan McDonagh	Independent Non-Executive Director
	Jim O'Hara	Independent Non-Executive Director
	Gerry Gaffney	Executive Director

SECRETARY

Diane Lumsden

REGISTERED OFFICE

The EBS Building
2 Burlington Road
Dublin 4
Ireland

REGISTERED NUMBER

463791

REGISTERED AUDITOR

Deloitte Ireland LLP
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 2018. A Directors' Responsibility Statement in relation to the financial statements appears on page 47.

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.

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 Euronext Dublin (formerly known as the Irish Stock Exchange).

The business strategy for 2019 will continue to entail the provision of liquidity to AIB via the issue of suitably rated European Central Bank ('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 is no expectation that a requirement will arise to re-purchase and cancel outstanding bonds during 2019.

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

The Bank's activities are financed through the issuance of mortgage covered securities with the balance of funding being provided by EBS.

The majority 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

Governance is exercised through a Board of Directors ('the Board') and a Senior Management Team. The Board is responsible for corporate governance encompassing leadership, direction and control of the Bank and is responsible for financial performance. 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. During 2018, there were 7 Directors on the Board. William Cunningham (Non-Executive Director) resigned as a director on 23 March 2018. Denis Holland (Non-Executive Director and Chair) resigned from the Board on 25 September 2018 and, Niamh Carolan (Group Non-Executive Director) resigned from the Board on 28 November 2018. As of 31 December 2018, the Board comprised of 2 Independent Non-Executive Directors and 2 Executive Directors, 1 of whom is the Managing Director.

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.

Directors' Report (continued)

Corporate Governance (continued)

The Board of Directors (continued)
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 2018, considered the outcome of internal and external audit activities.

Corporate Governance Requirements
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 the resignations of Denis Holland (Non-Executive Director and Chairman) on 25 September 2018 and Niamh Carolan (Group Non-Executive Director) on 28 November 2018, EBS MF was deemed to not be compliant with the 2015 Requirements as it did not have the required 5 Directors on the Board and furthermore, following the resignation of Denis Holland, EBS MF was not compliant with the requirement to have a Chair.

Helen Dooley was appointed to the Board of EBS MF as Group Non-Executive Director and Chair with effect from 30 January 2019 bringing the Bank into compliance with the 2015 Requirements.

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 Euronext Dublin (formerly known as 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 AIB 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 management including Finance, Internal Audit and Risk. At its meetings during 2018 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

The key Income Statement and Statement of Financial Position movements are highlighted below:

	2018	2017	
Net interest income ('NII')	**€122m**	€165m	Reduction in NII, being impact of 2017 and 2018 fixed and variable price reductions and increased funding costs due to the application of a new transfer pricing agreement.
Administrative expenses	**€71m**	€98m	In 2018, expenses decreased by €27m being a reduction in the service charge driven by updated inputs to the Return on Equity ('ROE') transfer pricing methodology calculations. The service charge reduction is offset by lower income as the mortgage book declines and higher direct costs mainly driven by a €10m charge (2017: €10m writeback) related to the Tracker mortgage examination.
Profit before tax	**€45m**	€30m	The increase in profit before tax is driven by the updated ROE transfer pricing calculations to reflect comparator entities results for the 3 year averaging period.
Loans & advances to customers	**€4,048m**	€4,450m	In 2018 mortgage balances fell by €563m, due a reduction in gross mortgage book of c. €558m, as a result of repayments & restructures being higher than new drawdowns This is offset by reduction in provision stock of c.€161m primarily due to reductions in stage 3 loans and write-offs.
Deposits by banks	**€729m**	€1,723m	Borrowings from EBS fell by €994m during 2018 due to the issuance of a series 18 €500m retained bond in December 2018 and the reduction in loans and advances to customers as the book declines.
Debt securities in issue	**€2,538m**	€2,022m	The Bank issued the Series 18 retained bond of €500m to EBS in December 2018.

Introduction of IFRS 9
As of 1 January 2018, IFRS 9 'Financial instruments' came into effect and has been applied in the preparation of the Bank's financial statements. Comparative figures have not been restated for the impact of IFRS 9 and are presented on an IAS 39 classification and measurement basis. On transition to IFRS 9, the Bank's reserves increased by €39m. See note 3 for further information on the impact of transition to IFRS 9.

Business review
The Irish economy improved generally during 2018 including a decreasing unemployment rate standing at 5.3% at the end of December 2018 against 6.2% in 2017 (Source: Central Statistics Office) and decreasing mortgage arrears. Total market mortgage drawdowns in Ireland were €8.7bn (Source: Banking & Payments Federation of Ireland ('BPFI')) in 2018 compared with €7.3bn in 2017, an increase of 19%.

Construction continued to rebound, with output up by 17% in the first three quarters of 2018. Housing output continued to rise steadily, albeit from low levels. Housing commencements were up by 24% to October 2018. Housing completions as reported by the CSO, rose by 25% to over 18,000 units in 2018, up from 14,400 the previous year. There was a sharp rise in planning permissions in 2018, with the number up by almost 70% in Q3 from 2017 levels

The CSO Residential Property Price Index showed an increase in prices nationally of 6.5% in the 12 months to December 2018 (12.3% in 2017). This was particularly evident outside Dublin where the 2018 annual increase was 9.6% (December 2017 13.3%). Property prices in Dublin increased in the 12 month period by 3.8% (increase of 11.6% in 2017). The residential property price fall from peak (February 2007) was 21.4% Dublin and 22.0% non-Dublin at 31 December 2018 (2017: 24.4% Dublin and 28.4% non-Dublin).

The Bank's loan portfolio before provisions decreased by 11.9% during 2018 to €4.2bn as at 31 December 2018 principally due to customer's repayments and loan restructuring and non-contracted write-offs (2017: decrease 8.3%).

The Bank's residential mortgage portfolio comprises gross loan balances of €4.2bn (2017:€4.7bn) €4.2bn Owner-Occupier (2017: €4.7bn) and €0.01bn Buy-To-Let mortgages (2017: €0.01bn).

Directors' Report (continued)

Business review (continued)
The Bank continues to make progress to complete the Tracker Mortgage Examination programme. In 2018 the Bank determined that an additional €10m was required for customer redress and compensation, all of which was utilised at 31 December 2018.

The Tracker Mortgage Examination programme is materially complete with close out activities now underway during 2019 and we are working closely with the Central Bank of Ireland in terms of their investigation. The Bank is aware that issues can and do continue to emerge from the past and when they do the Bank is committed to dealing with them in a transparent and fair way for our customers.

Asset Quality
Loans and advances to customers (before impairment loss allowances) at amortised costs amounted to €4.2bn at 31 December 2018 (2017: €4.7bn). Non-performing loans decreased from €806m at 31 December 2017 to €558m at 31 December 2018. This reduction was achieved through redemptions and repayments from customers, loan restructuring activity including non-contracted write-offs and asset sales/disposals together with the implementation of a new definition of default policy.

A significant element of this 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, EBS and the customer can find a mutually acceptable and alternative way forward. This approach has, and will continue to, materially improve EBS's asset quality and lower its overall risk profile, and strengthen its solvency. EBS 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. EBS 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.

Expected credit losses measured under IFRS 9 are €0.1bn (2017 impairment provisions under IAS 39 were €0.3bn). The movement is largely attributable to IFRS 9 transition adjustment of €45m and write-offs including non-contracted of €129m. EBS has credit policies and strategies, implementation guidelines and monitoring structures in place to manage its loan portfolios, including restructured loans. EBS regularly reviews the performance of these restructured loans and has a dedicated team to focus on asset sales within the restructured portfolio. EBS 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. EBS continues to review all options in relation to reducing impaired loans including sales and strategic initiatives.

Funding activities
There was a favourable technical market backdrop for covered bonds in 2018, with the ECB's covered bond purchase programme ("CBPP3") continuing to actively buy bonds in both the primary and secondary markets during the year. CBPP3 is aimed at enhancing the functioning of the monetary policy transmission mechanism, supporting financing conditions in the euro area, and facilitating credit provision to the real economy. As of 23 February 2019, the holdings under CBPP3 amount to circa €262.5bn (2017: c. €247bn). The ECB announced at its October 2017 meeting that it will scale back asset purchases under its Quantitative Easing (QE) programme from the start of 2018. The ECB forward guidance indicates that interest rates will remain at their current very low levels until at least December 2019. The ECB deposit rate stands at negative 0.4%.

Covered bond spreads widened over the course of 2018, as investors began to reprice risk in the knowledge that QE would likely be ending/reducing towards year end. The Bank did not issue covered bonds to external market investors in 2018 in line with AIB's overall funding priorities and plan.

At 31 December 2018, the total amount of principal outstanding in respect of mortgage covered securities issued was €2.5bn (31 December 2017: €2bn) subscribed for in full by EBS. The Bank issued the Series 18 covered bonds of €500m on 19 December 2018.

The ratings as at 31 December 2018, 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**	**Baa3**	**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 bond programme continues to be rated by Moodys at Aaa.

Directors' Report (continued)

Share capital
The share capital of the Bank is €552m (2017: €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 20 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 2018 and 31 December 2017.

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.

	CRD IV Transitional basis		**CRD IV Fully loaded**	
	31 December 2018	31 December 2017	**31 December 2018**	31 December 2017
	€ m	€ m	**€ m**	€ m
Shareholders' equity	**851**	773	**851**	773
Total Tier 1 capital	**851**	773	**851**	773
Tier 2 Capital				
Credit provisions	**-**	12	**-**	-
Total Tier 2 capital	**-**	12	**-**	-
Total capital	**851**	785	**851**	773
Risk weighted assets				
Credit risk	**1,758**	1,959	**1,758**	1,959
Operational risk	**221**	173	**221**	173
Total risk weighted assets	**1,979**	2,132	**1,979**	2,132
Total Tier 1 capital ratio	**43.0%**	36.3%	**43.0%**	36.3%
Total capital ratio	**43.0%**	36.8%	**43.0%**	36.3%

The Bank is required to maintain a Core Equity Tier 1 ratio of 7% effective from 1 January 2019 (2018: 6.375%). This includes a Pillar 1 requirement of 4.5% and a capital conservation buffer ("CCB") of 2.5% (2017: 1.875%). The minimum requirement for the transitional total capital ratio is 10.5% (2018: 9.875%). The transitional Total Tier 1 and Total capital ratios at 31 December 2018 were 40.8% and 45.6% respectively (2017: 33.8% and 38.3% 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.

In 2018 the Bank has completed a review of the level of capital required and the Board approved the submission of an application to the Bank's regulator seeking permission to complete a capital reorganisation, including the repayment of capital to AIB plc. As of the date of these accounts, the decision of the regulator is pending.

Risk Management
The Bank adopts the same risk management framework and risk mitigation initiatives as AIB. The risk management framework provides a 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 46 and included the following:

Credit risk;
Restructure execution risk;
Funding and liquidity risk;
Capital adequacy risk;
Market risk;
Operational risk;
Regulatory compliance risk including conduct risk;
People and culture risk;
Business model risk;
Model risk

Outlook for 2019

Most forecasters see economic growth in Ireland slowing to around 4.0%-4.5% in 2019, taking into account the UK's departure from the EU, a softening in global growth and a slower pace of job creation as the economy moves towards full employment. However, this would still be a very good growth performance by the Irish economy.

Leading indicators of activity have softened in recent months, but continue to point to good prospects for the economy. Growth should be underpinned by continuing low interest rates, rising employment and incomes, the ongoing rebound in construction activity as well as a more expansive stance to fiscal policy. This should result in a strong rise in new lending activity in 2019. However, this is all predicated on the assumption that a disorderly hard Brexit and a marked slowdown in the world economy are avoided in the coming year.

Brexit

Ongoing uncertainty following the UK vote to exit the EU, relating to the nature and impact of withdrawal, could impact the Bank. This includes pricing, customer confidence and credit demand, collateral values and customers' ability to meet their financial obligations. This, in turn, could have an impact on the Bank's financial performance, balance sheet, and capital.

Other effects may include changes in official interest rate policy in the Eurozone, which can impact the Bank's revenues. The Bank continues to closely monitor the impact on the Irish economy and the Bank, and manage that change, and the specific risks and challenges associated with same.

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 2019 to 2021 approved by the Board in December 2018, 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 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 2018. Independent Non-Executive Directors do not participate in long term incentive plans.

Directors' Report (continued)

Attendance at scheduled Board Meetings

	Board (Scheduled)		Board (Out of course)	
Directors	**Eligible to Attend**	**Attended**	**Eligible to Attend**	**Attended**
Denis Holland (resigned 25 September 2018)	3	3	-	-
Niamh Carolan (resigned 23 November 2018)	3	1	1	-
William Cunningham (resigned 23 March 2018)	1	-	-	-
Chris Curley	4	4	1	1
Gerry Gaffney	4	4	1	-
Brendan McDonagh	4	3	1	1
Jim O'Hara	4	4	1	1

The Board held 5 scheduled meetings during 2018.

Directors and Secretaries

The following were Directors of the Bank during 2018 – William Cunningham (resigned 23 March 2018 Denis Holland (resigned 25 September 2018) and Niamh Carolan (resigned 23 November 2018), Chris Curley, Gerry Gaffney, Brendan McDonagh, and Jim O'Hara.

Helen Dooley was appointed as a Director of the Company with effect from 30 January 2019.

The Company Secretaries were Ms. Cara Teahan and Ms. Diane Lumsden (appointed 6 December 2018).

There were no changes in the Directors' and Secretary's interests between 31 December 2018 and 26 March 2019.

Directors Remuneration

Details of total remuneration of the Directors in office during 2018 and 2017 are shown in the Remuneration Table in note 9.

Dividend

There was no interim dividend paid to the shareholder during 2018 and the Board is not recommending the payment of a final dividend for 2018 (2017: 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 Bank 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 2018.

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 Auditor is 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 Auditor is aware of that information.

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

Independent auditor
Deloitte Ireland LLP, 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,

Helen Dooley
Chair

DATE: 26 MARCH 2019

Chris Curley
Managing Director

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 a customer or counterparty being unable or unwilling to meet their contractual obligations.

Credit risk can be categorised into the following three sub-risks;

i. Counterparty risk: The risk of losses arising as a result of the counterparty not meeting its contractual obligations in full and on time;

ii. Credit default risk: The current or prospective risk to capital arising from the obligors' failure to meet the terms of any contract with the Bank;

iii. Concentration risk: The risk of excessive credit concentration including to an individual, counterparty, group of connected counterparties, a type of collateral or a type of credit facility.

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 and key principles

The principles and activities which govern the management of credit risk within the Bank are as follows. These principles apply across the Bank in the management of credit risk.

– *Formulating and implementing a comprehensive credit risk strategy*
  Formulate and implement a comprehensive credit risk strategy that is viable through various economic cycles, supported by a robust suite of credit policies that support the Bank's approved RAS and generate appropriate returns on capital within acceptable levels of credit quality.
– *Establishing appropriate governance structures*
  Establish governance authority fora to provide independent oversight and assurance to the Board with regards to credit risk management activities and the quality of the credit portfolio.
– *Developing and reinforcing a strong risk focused culture*
  Develop and continuously reinforce a strong, risk focused culture across the credit risk management functions through the credit cycle, which supports the Bank's goals and enables business growth, provides constructive challenge and avoids risks that cannot be adequately measured.
– *Undertaking credit assessments within a sound and well defined credit granting process*
  Operate within a sound and well defined credit granting process, within which risks for new and existing lending exposures are identified, assessed, measured, managed and reported in line with risk appetite and the credit risk policy.
– *Establishing and enforcing effective monitoring and controls*
  Establish and enforce an efficient internal review and reporting system to manage effectively the Bank's credit risk across various portfolios including, establishing and enforcing internal controls and assurance practices to ensure that exceptions to policies, deviations to credit standards, procedures and limits are monitored and reported in a timely manner for review and action.
– *Maintaining sound methodology to identify deteriorating credit quality*
  Ensure sound methodology exists to proactively assess risk and to identify deteriorating credit quality to minimise losses and maximise recoveries in work out scenarios.
– *Using high quality management information for effective risk measures*
  Utilise quality management information and risk data to ensure an effective credit risk measurement process when reporting on the holistic risk profile of the Bank including any changes in risk profile and emerging or horizon risks.
– *Mitigating credit risk arising from new or amended products*
  Mitigate potential credit risk arising from new or amended products or activities.

Credit risk organisation and structure

The Bank's credit risk management systems operate through a hierarchy of lending authorities. The Bank relies on the AIB credit risk framework and its supporting policies, processes and governance. All customer mortgage applications are subject to an individual credit assessment process. The role of the Credit Risk function is to provide direction, independent oversight and challenge of credit risk-taking.

Credit approval overview

The Bank operates credit approval criteria which:

– Includes a clear indication of the Bank's target market(s), in line with Bank appetite statements;
– Requires a thorough understanding and assessment of the borrower or counterparty, as well as the purpose and structure of credit, and the source of repayment; and
– Enforces compliance with minimum credit assessment and facility structuring standards.

Risk Management Report (continued)

3.1. Credit risk

Credit approval overview (continued)

Credit risk approval is undertaken by professionals operating within a defined delegated authority framework. At the Group level the AIB Board is the ultimate credit approval authority and grants authority to various credit committees and individuals to approve limits. Credit limits are approved in accordance with the Bank's written risk policies and guidelines. All exposures above certain levels require approval by the AIB Group Credit Committee ("GCC") and/or Board. Other exposures are approved according to a system of tiered individual authorities which reflect credit competence, proven judgement and experience. Depending on the borrower/connection, grade or weighted average facility grade and the level of exposure, limits are sanctioned by the relevant credit authority. Material lending proposals are referred to credit units for independent assessment/approval or formulation of a recommendation and subsequent adjudication by the applicable approval authority.

Internal credit ratings*

One of the objectives of credit risk management is to accurately quantify the level of credit risk to which the Bank is exposed. The use of internal credit risk rating models is fundamental in assessing the credit quality of loan exposures, with variants of these used for the calculation of regulatory capital. All relevant exposures are assigned to a rating system and within that to an internal risk grade. A grade is assigned on the basis of rating criteria within each rating model from which estimates, of probability to default ("PD") are derived (i.e. through the cycle).

Internal 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. Enhanced credit management is in place and special attention is paid to lower quality performing loans or 'criticised' loans and non-performing/defaulted loans which are defined below

The Bank implemented IFRS 9 at 1 January 2018. The IFRS 9 PD modelling approach uses a combination of rating grades and scores obtained from these credit risk models along with key factors such as age of an account, the current/recent arrears status or the current/recent forbearance status and macro-economic factors to obtain the relevant IFRS 9 12 month and Lifetime PDs (i.e. point in time). The Bank has set out its methodologies and judgements exercised in determining its expected credit loss ("ECL") under IFRS 9 on pages 19 to 26.

Using internal models, the Bank designed and implemented a credit grading masterscale that gives it the ability to categorise and contrast credit risk across different portfolios in a consistent manner. The masterscale consolidates complex credit information into a single attribute, aligning the output from risk models with the Bank's definition of default ("DoD") policy. Credit grades are driven by model appropriated PDs in order to provide the Bank with a mechanism for ranking and comparing credit risk associated with a range of customers. The masterscale categorises loans into a broad range of grades which can be summarised into the following categories: strong/satisfactory grades, criticised grades and non-performing loans.

Strong/satisfactory

Accounts are considered strong/satisfactory if they have no current or recent credit distress and the probability of default is typically less than 6.95%, they are not in arrears and there are no indications that they are unlikely to repay.

Strong (typically with PD less than 0.99%): Strong credit with no weakness evident.
Satisfactory (typically with PD greater than 0.98% and less than 6.95%): Satisfactory credit with no weakness evident.

Criticised

Accounts of lower quality and considered as less than satisfactory are referred to as criticised and include the following:
Criticised watch: The credit is exhibiting weakness in terms of credit quality and may need additional management attention; the credit may or may not be in arrears.
Criticised recovery: Includes forborne cases that are classified as performing including those which have transitioned from default forborne, but still require additional management attention to monitor for re-default and continuing improvement in terms of credit quality.

Non-performing/default

On 1 January 2018, the Bank introduced a new definition of default aligned with the EBA 'Guidelines on the application of the definition of default' under Article 178 of Capital Requirements Regulation and ECB Banking Supervision Guidance to Banks on Non-performing loans. The Bank has aligned the definitions of 'non-performing loans', 'classification of default' and IFRS 9 Stage 3 'credit impaired', with the exception of those loans which have been derecognised and newly originated in Stage 1 or POCI (Purchased or Originated Credit Impaired).

*Forms an integral part of the audited financial statements

3.1 Credit risk (continued)

Non-performing/default (continued)

Loans are identified as non-performing or defaulted by a number of characteristics. The key criteria resulting in a classification of non-performing are:

- Where the Bank considers a credit obligor to be unlikely to pay his/her credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount.
- The credit obligor is 90 days or more past due on any material credit obligation. Date count starts where any amount of principal, interest or fee has not been paid by a credit obligor on the due date.

The trigger for default is based on a calculation of the sum of all past due amounts related to the credit obligation for a retail credit obligor. The Bank's definition of financial distress, forbearance, non-performing exposures and unlikeliness to pay are included in the Bank's Definition of Default policy.

Non-performing loans that have received a concession from the Bank on terms or conditions will remain in the non-performing probationary period for a minimum of 12 months, and are subject to meeting defined probation criteria before moving to a performing classification.

Non-performing loans are analysed in more detail on page 35, and are further analysed below as follows:

Unlikely to pay – Where the Bank considers a credit obligor to be unlikely to pay their credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount or the number of days past due.
Greater than 90 days past due – Credit obligor that is past due by 90 days or more on any material obligation.
Collateral disposals – Post restructure cases requiring asset disposal as part of the restructure agreement. These loans will remain as non-performing until the asset is sold and the loan cleared.
Non-performing loans probation – Loans that have, as a result of financial distress, received a concession from the Bank on terms or conditions, and that are currently operating in line with the post restructure arrangements, and will remain in the non-performing probationary period for a minimum of 12 months before moving to a performing classification.

The new masterscale categories outlined above are materially different to the grade categories the Bank used in previous years (and in 2017 comparatives set out on page 28) and are therefore not directly comparable. The previous years' definitions of grade categories are set out below:

Satisfactory: *Loans that are neither watch, vulnerable or impaired are considered satisfactory. These loans are further analysed into:*
Good upper: *Strong credit with no weakness evident. Typically includes elements of the residential mortgages portfolio combined with strong corporate and commercial lending.*
Good lower: *Satisfactory credit with no weakness evident. Typically includes new business written and existing satisfactorily performing exposures across all portfolios.*
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, or loans that are in a post impairment/restructuring phase.*
Impaired: *A loan is impaired if there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the assets (a 'loss event') and that loss event (or events) has an impact such that the present value of estimated 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.*

Credit risk principles and policy*

The Bank implements and operates policies to govern the identification, assessment, approval, monitoring and reporting of credit risk. The Bank Credit Risk Framework and Bank Credit Risk Policy are overarching Board approved documents which set out, at a high level, the principles of how the Bank identifies, assesses, approves, monitors and reports credit risk to ensure robust credit risk management is in place. These documents contain the minimum standards and principles that are applied across the Bank to provide a common, robust and consistent approach to the management of credit risk.

The Bank Credit Risk Policy is supported by a suite of credit policies, standards and guidelines which define in greater detail the minimum standards and credit risk metrics to be applied for specific products, business lines, and market segments.

Credit Risk, as an independent risk management function, monitors key credit risk metrics and trends, including policy exceptions and breaches, reviews the overall quality of the loan book; challenges variances to planned outcomes and tracks portfolio performance against agreed credit risk indicators. This allows the Bank, if required, to take early and proactive mitigating actions for any potential areas of concern.

In circumstances where a policy breach occurs, it must be reported to Senior Management and Credit Risk to assess the nature of the breach and any required remedial action to mitigate the likelihood of re-occurrence.

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk (continued)

Maximum exposure to credit risk*

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 is their carrying amount, and for financial guarantees. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

The following table sets out the maximum exposure to credit risk that arises within the Bank and distinguishes between those assets that are carried in the statement of financial position at amortised cost and those carried at fair value at 31 December 2018 and 2017:

	Amortised Cost(1)	**Fair Value(2)**	**2018 Total**	Amortised Cost	Fair Value	2017 Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Derivative financial instruments	**-**	**23**	**23**	-	20	20
Loans and advances to banks	**75**	**-**	**75**	69	-	69
Loans and advances to customers	**4,048**	**-**	**4,048**	4,450	-	4,450
Included elsewhere:						
Accrued interest	**-**	**-**	**-**	-	-	-
Other assets	**-**	**-**	**-**	-	-	-
	4,123	**23**	**4,146**	4,519	20	4,539
Off balance sheet loan commitments	**9**	**-**	**9**	12	-	12
Maximum exposure to credit risk	**4,132**	**23**	**4,155**	4,531	20	4,551

(1) All amortised cost items are loans and advances which are in a 'held-to-collect' business model.
(2) All items measured at fair value are classified as 'fair value through profit or loss'.

Credit risk monitoring*

AIB Group has developed and implemented processes and information systems to monitor and report on individual credits and credit portfolios in order to manage credit risk effectively. It is AIB Group's practice to ensure that adequate up to date credit management information is available to support the credit management of individual account relationships and the overall loan portfolio.

Credit risk, at a portfolio level, is monitored and reported regularly to Senior Management and the Board. Credit managers proactively manage AIB Group's credit risk exposures at a transaction and relationship level. Monitoring is done through credit exposure and excess management, regular review of accounts, being up to date with any developments in customer circumstances, obtaining updated financial information and monitoring of covenant compliance. This is reported on a quarterly basis to Senior Management and includes information and detailed commentary on loan book growth, quality of the loan book and expected credit losses including individual large non-performing exposures.

Changes in sectoral and single name concentrations are tracked on a quarterly basis highlighting changes to risk concentration in the AIB Group's loan book. A report on any exceptions to credit policy is presented and reviewed on a regular basis. The AIB Group's allocates significant resources to ensure ongoing monitoring and compliance with approved risk limits. Credit risk, including compliance with key credit risk limits, is reported monthly. Once an account has been placed on a watch list, or early warning list, the exposure is carefully monitored and where appropriate, exposure reductions are effected.

Criticised borrowers are subject to an 'unlikely to pay' test at the time of annual review, or earlier, if there is a material adverse change or event in their credit risk profile

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk (continued)

Credit risk monitoring*(continued)

The AIB Group operates a number of schemes to assist borrowers who are experiencing financial stress. The material elements of these schemes through which AIB Group has granted a concession, whether temporarily or permanently are set out below. AIB Group employs a dedicated approach to loan workout and to monitoring and proactively managing non-performing loans. Specialised teams focus on managing the majority of criticised loans. Specialist recovery functions deal with customers in default, collection or insolvency. Their mandate is to maximise return on non-performing debt and to support customers in difficulty. Whilst the basic principles for managing weaknesses are broadly similar, the solutions reflect the differing nature of the assets.

Forbearance*

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

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

Mortgage portfolio

Under the mandate of the Central Bank's Code of Conduct on Mortgage Arrears ("CCMA"), the Bank introduced a four-step process called the Mortgage Arrears Resolution Process, or MARP. This process aims to engage with, support and find resolution for mortgage customers (for their primary residence only) who are in arrears, or are at risk of going into arrears.

The four step process is summarised as follows:

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

Low fixed interest rate sustainable solution – This solution aims 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 repayments on their mortgage based on the 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 the full capital and agreed 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, where applicable;

Negative equity trade down – This solution allows a customer to sell his/her 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;

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 selling the property and putting an appropriate agreement in place to repay any residual debt. This solution may also include an element of debt write-off, where applicable.

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

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

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk (continued)
Mortgage portfolio (continued)
The restructuring process is one of structured engagement to assess the long term levels of sustainable and unsustainable debt. The process broadly moves from an initial customer disclosure stage, through to engagement and analysis, through to an initial proposal from the Bank, followed by credit approval, documentation and drawdown. The commercial aspects of this process require that customer affordability is viewed holistically, to include all available sources of finance for debt repayment, including unencumbered assets.

The debt solutions provided allow the customer to enter into a performance based arrangement, typically over a five year period, which will be characterised by the disposal of non-core assets, contribution of unencumbered assets, and contribution towards residual debt from available cash flow. This process may result in debt write-off, where applicable.

A request for forbearance is a trigger event for the Bank to undertake an assessment of the customer's financial circumstances prior to any decision to grant a forbearance treatment. This may result in the downgrading of the credit grade assigned and an increase in the expected credit loss. Loans to which forbearance has been applied continue to be classified as forborne until the forbearance measures expire or until an appropriate probation period has passed.

See accounting policy 1.9 'Impairment of financial assets' in note 1 to the financial statements.

The effectiveness of the forbearance measures over the lifetime of the arrangements are subject to ongoing management and review. 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 Bank and the borrower.

Credit risk mitigants*
The perceived strength of a borrower's repayment capacity is the primary factor in granting a loan. However, AIB uses various approaches to help mitigate risks relating to individual credits, including transaction structure, collateral and guarantees. Collateral or guarantees are usually required as a secondary source of repayment in the event of the borrower's default. The main types of collateral for loans and advances to customers are described below under the section on Collateral. Credit policy and credit management standards are controlled and set centrally by the Credit Risk function.

The Bank enters into netting agreements for derivatives with certain counterparties, to ensure that in the event of default, all amounts outstanding with those counterparties will be settled on a net basis. Derivative transactions with wholesale counterparties are typically collateralised under a Credit Support Annex in conjunction with the International Swaps and Derivatives Association ("ISDA") Master Agreement.

The Bank also has in place an interbank exposure policy which establishes the maximum exposure for each counterparty bank depending on credit rating. Each bank is assessed for the appropriate exposure limit within the policy. Risk generating business units in each segment are required to have an approved bank or country limit prior to granting any credit facility, or approving any obligation or commitment which has the potential to create interbank or country exposure.

Collateral
Credit risk mitigation may include a requirement to obtain collateral as set out in the Bank's lending policies. Where collateral or guarantees are required, they are usually taken as a secondary source of repayment in the event of the borrower's default. The Bank maintains policies which detail the acceptability of specific classes of collateral.

The principal collateral types for loans and advances are:
– Charges over business assets such as premises, inventory and accounts receivable;
– Mortgages over residential and commercial real estate; and
– Charges over financial instruments such as debt securities and equities.

The nature and level of collateral required depends on a number of factors such as the type of the facility, the term of the facility and the amount of exposure. Collateral held as security for financial assets other than loans and advances is determined by the nature of the instrument. Debt securities and treasury products are generally unsecured, with the exception of asset backed securities, which are secured by a portfolio of financial assets.

Collateral is not usually held against loans and advances to banks, including central banks, except where securities are held as part of reverse repurchase or securities borrowing transactions or where a collateral agreement has been entered into under a master netting agreement.

Methodologies for valuing collateral
As mortgage loans represent a significant concentration within the Bank's loans and advances portfolio, some key principles have been applied in respect of property collateral held by the Bank.

*Forms an integral part of the audited financial statements

3.1 Credit risk (continued)

Credit risk mitigants* (continued)

Methodologies for valuing collateral (continued)

In accordance with the Bank's policy and guidelines on Property Collateral Valuation, the Bank uses a number of methods to assist in reaching appropriate valuations for property collateral held. These include:

– Use of independent professional external valuations; and
– Use of internally developed methodologies, including residual valuations.

Use of independent professional external valuations represent circumstances where external firms are engaged to provide formal written valuations in respect of the property. Up to date external independent professional valuations are sought in accordance with the Bank's Property Valuation Policy and Guidelines. Available market indices for relevant assets, e.g. residential property are also used in valuation assessments, where appropriate. When assessing the value of residential properties, recent transactional analysis of comparable sales in an area combined with the Central Statistics Office ("CSO") Residential Property Price index in the Republic of Ireland may be used.

Property collateral is reviewed on a regular basis in accordance with the Property Valuation policy and Guidelines.
Applying one or a combination of the above methodologies, in line with the Bank's Valuation Policy, has resulted in a wide range of discounts to original collateral valuations, influenced by the nature, status and year of purchase of the asset. The frequency and availability of such up-to-date valuations remain a key factor within ECLs determination. Additionally, all relevant costs likely to be associated with the realisation of the collateral are taken into account in the cash flow forecasts. The spread of discounts is influenced by the type of collateral, e.g. Buy-To-Let, residential and also its location. The valuation arrived at is therefore, a function of the nature of the asset.

When assessing the level of ECL allowance required for property loans, apart from the value to be realised from the collateral, other cash flows, such as recourse to other assets or sponsor support, are also considered, where available. The other key driver is the time it takes to receive the funds from the realisation of collateral. While this depends on the type of collateral and the stage of its development, the period of time to realisation is typically one to five years but sometimes this time period is exceeded. These estimates are periodically reassessed on a case by case basis.

The value of collateral is assessed at origination of the loan and throughout the credit life cycle (including annual reviews where required). When undertaking an ECL assessment for individually assessed cases that have been deemed unlikely to pay, the present value of future cash flows, including the value of collateral held, and the likely time taken to realise any security is estimated. An ECL allowance is raised for the difference between this present value and the carrying value of the loan.

Loans and advances to customers – residential mortgages

The following table shows the estimated fair value of collateral held for the Bank's residential mortgage portfolio at 31 December 2018. Comparative data for 2017 has been prepared under IAS 39.

	2018					2017			
	Measured at amortised cost								
	Stage 1 € m	**Stage 2 € m**	**Stage 3 € m**	**POCI € m**	**Total € m**	Neither past due nor impaired € m	Past due but not impaired € m	Impaired € m	Total € m
Fully collateralised[(1)]									
Loan-to-value ratio:									
Less than 50%	1,189	107	87	9	1,392	1,196	38	57	1,291
50% - 70%	898	128	97	21	1,144	1,011	43	72	1,126
71% - 80%	402	52	50	11	515	456	22	48	526
81% - 90%	309	46	42	12	409	442	16	52	510
91% -100%	290	51	47	11	399	358	12	56	426
	3,088	384	323	64	3,859	3,463	131	285	3,879
Partially collateralised									
Collateral value relating to loans over 100% loan-to-value	102	34	134	6	276	467	27	251	745
Total collateral value	**3,190**	**418**	**457**	**70**	**4,135**	3,930	158	536	4,624
Gross carrying value residential mortgages	**3,194**	**421**	**488**	**74**	**4,177**	3,970	162	608	4,740
Loss allowance	(1)	(11)	(109)	(8)	(129)				
Statement of financial position: specific provisions								(243)	(243)
Statement of financial position: IBNR provisions									(47)
Total carrying amount	**3,193**	**410**	**379**	**66**	**4,048**			365	4,450

(1) The 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.

Risk Management Report (continued)

3.1 Credit risk (continued)

Collateral for the residential mortgage portfolio

For residential mortgages, the Bank takes collateral in support of lending transactions for the purchase of residential property. Collateral valuations are required at the time of origination of each residential mortgage. The value at 31 December 2018 is estimated based on property values at origination or date of latest valuation and applying the CSO Residential Property Price Index.

ECL governance

AIB Group has put in place a framework, incorporating the governance and delegation structures commensurate with a material risk, to ensure credit risk is appropriately managed throughout the Group.

The key governance points in the AIB ECL approval process during 2018 were:

- Model Risk Committee
- Assets and Liabilities Committee
- Business level ECL Committees
- Group Credit Committee, and
- Executive Risk Committee / Executive Committee / Board Audit Committee

For ECL governance, the Bank management employs its expert judgement on the adequacy of ECL. The judgements are supported by detailed information on the portfolios of credit risk exposures, and by the outputs of the measurement and classification approaches described above, coupled with internal and external data provided on both short term and long-term economic outlook. Business segments and Bank management are required to ensure that there are appropriate levels of cover for all of its credit portfolios and must take account of both accounting and regulatory compliance when assessing the expected levels of loss.

Assessment of the credit quality of each business segment is initially informed by the output of the quantitative analytical models but may be subject to management adjustments. This ECL output is then scrutinised and approved at individual business unit level (ECL Committee) prior to onward submission to the Credit Committee. The Credit Committee reviews and challenges ECL levels prior to recommendation to the Executive Risk Committee / Executive Committee and Board Audit Committee.

In addition the Bank's senior management reviews and challenges the ECL levels prior to recommendation to the Bank's Audit Committee.

Measurement, methodologies and judgements*

Introduction

The Bank has set out the methodologies used and judgements exercised in determining its expected credit loss ("ECL") for both transition to IFRS 9 at 1 January 2018 and for the year to 31 December 2018.

IFRS 9 introduces the expected credit loss impairment model that will require a more timely recognition of ECL across AIB. IFRS 9 replaces the concept of recognising credit losses only when there is objective evidence that a loss has been incurred. The impairment requirements under IFRS 9 are based on an expected credit loss model and replace the IAS 39 incurred loss model. The standard does not prescribe specific approaches used to estimate the ECL, but stresses that the approach must reflect the following:

– An unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes;
– Underlying models should be point in time – recognising economic conditions;
– The ECL must reflect the time value of money;
– A lifetime ECL is calculated for financial assets in Stage 2 and 3; and
– Models used in the ECL calculation must incorporate reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

*Forms an integral part of the audited financial statements

3.1 Credit risk

Measurement, methodologies and judgements* (continued)

The standard defines credit loss as the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e. all cash shortfalls), discounted at the original effective interest rate ("EIR") or an approximation thereof (see 'Measurement' section below). ECLs are defined in IFRS 9 as the weighted average of credit losses across multiple macroeconomic scenarios, the probability of each scenario occurring as weights and are an estimate of credit losses over the life of a financial instrument.

A key principle of the ECL model is to reflect any relative deterioration or improvement in the credit quality of financial instruments occurring (e.g. change in the risk of a default). The ECL amount recognised as a loss allowance or provision depends on the extent of credit deterioration since initial recognition together with the usual credit risk parameters.

Measurement bases

Under IFRS 9, there are two measurement bases:

1. 12-month ECL (Stage 1), which applies to all financial instruments from initial recognition as long as there has been no significant increase in credit risk;
2. Lifetime ECL (Stages 2 and 3 and POCI), which applies when a significant increase in credit risk has been identified on an account (Stage 2), an account has been identified as being credit-impaired (Stage 3) or when an account meets the Purchased or Originated Credit Impaired(POCI) criteria.

Staging

Under IFRS 9, financial assets are allocated to stages dependent on credit quality relative to when assets were originated.

Credit risk at origination

Credit risk at origination ("CRAO") is a key input into the staging allocation process. The origination date of an account is determined by the date on which the Bank became irrevocably committed to the contractual obligation and the account was first graded on an appropriate model.

For undrawn credit facilities, the Bank uses the date of origination as the date when it becomes party to the irrevocably contractual arrangements or irrevocable commitment. The Bank uses best available information for facilities which originated prior to credit risk rating model or scorecard being in place.

For accounts that originated prior to 1 January 2018, a neutral view of the macroeconomic outlook at the time is used, i.e. where macroeconomic variables are used in the Lifetime PD models, long-run averages are used instead of historical forecasts.

Stage 1 characteristics

Obligations are classified Stage 1 at origination, unless purchased or originated credit impaired ("POCI"), with a 12 month ECL being recognised. These obligations remain in Stage 1 unless there has been a significant increase in credit risk.

Accounts can also return to Stage 1 if they no longer meet either the Stage 2 or Stage 3 criteria, subject to satisfaction of the appropriate probation periods, in line with regulatory requirements.

Stage 2 characteristics

Obligations where there has been a 'significant increase in credit risk' ("SICR") since initial recognition but do not have objective evidence of credit impairment are classified as Stage 2. For these assets, lifetime ECLs are recognised.

The Bank assesses at each reporting date whether a significant increase has occurred on its financial assets since their initial recognition. This assessment is performed on individual assets rather than at a portfolio level. If the increase is considered significant, the obligation will be allocated to Stage 2 and a lifetime expected credit loss will apply to the obligation. If the change is not considered significant, a 12 month expected credit loss will continue to apply and the obligation will remain in Stage 1.

The Bank's SICR assessment is determined based on:

Quantitative measure: This measure reflects an arithmetic assessment of the change in credit risk arising from changes in the probability of default. The Bank compares each obligation's annualised average probability weighted residual lifetime probability of default ("LTPD") at origination (see the CRAO section) to its annualised average probability weighted residual LTPD at the reporting date. If the difference between these two LTPDs meets the quantitative definition of SICR, the Bank moves the financial asset into Stage 2. Increases in LTPD may be due to credit deterioration of the individual asset or due to macroeconomic factors. The Bank has determined that an account has met the quantitative measure if the average residual LTPD at the reporting date is more than double the average residual LTPD at origination. This is subject to the difference between the LTPDs being at least 50bps.

*Forms an integral part of the audited financial statements

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Qualitative measure: This measure reflects the assessment of the change in credit risk based on the Bank's credit management of and the individual characteristics of the financial asset. This is not model driven and seeks to capture any change in credit quality that may not be already captured by the quantitative criteria. The qualitative assessment reflects pro-active credit management and includes direct client contact, monitoring of client accounts on an individual or portfolio level, knowledge of client behaviour, and cognisance of industry and economic trends.

The criteria for this trigger include, for example:
– A downgrade of the borrower's/facility's credit grade reflecting the increased credit management focus on these accounts; and
– Forbearance has been provided and the account is within the probationary period.

Backstop indicators: The Bank has adopted the rebuttable assumptions within IFRS 9 that credit obligations greater than 30 days past due represent a significant increase in credit risk.

Where SICR criteria is no longer a trigger and the obligor is not credit-impaired, the account can exit Stage 2.

Stage 3 characteristics
Defaulted obligations (with the exception of newly originated loans which are in Stage 1 or POCI) are classified as credit impaired and allocated to Stage 3. Where default criteria is no longer met, the obligor exits Stage 3 subject to probation period in line with regulatory requirements.

Two key criteria resulting in a classification of default are:
- Where the Bank considers a credit obligor to be unlikely to pay his/her credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount.
- The credit obligor is 90 days or more past due on any material credit obligation (count starts where any amount of principal, interest or fee has not been paid by a credit obligor at the date it was due).

The trigger for default is based on a calculation of the sum of all past due amounts related to the credit obligation for a customer. The Bank's definition of financial distress, forbearance, nonperforming exposures and unlikeliness to pay are included in the Bank's Definition of Default policy. Loans can re-default if any of the default triggers apply or where probation requirements are not adhered to.

Purchased or originated credit impaired (POCI)
POCIs are assets originated credit impaired where the difference between the discounted contractual cash flows and the fair value at origination is greater than or equal to 5%. The Bank uses an appropriate discount rate for measuring ECL in the case of POCIs which is the credit-adjusted EIR. This rate is used to discount the expected cash flows of such assets to fair value on initial recognition.

POCIs remain outside of the normal stage allocation process for the lifetime of the obligation. The ECL for POCIs is always measured at an amount equal to lifetime expected credit losses. The amount recognised as a loss allowance for these assets is the cumulative changes in lifetime expected credit losses since the initial recognition of the assets rather than the total amount of lifetime expected credit losses.

Measurement
The measurement of ECL is estimated through one of the following approaches:

i Standard approach: This approach is used for the majority of exposures where each ECL input parameter (Probability of Default - PD, Loss Given Default - LGD, Exposure at Default - EAD, and Prepayments - PP) is developed in line with standard modelling methodology which is set out in AIB's IFRS 9 ECL Model Framework and has been approved by the relevant governance forum. The Bank's IFRS 9 models have been approved through AIB's Model Governance Framework.

ii. Simplified approach: For immaterial portfolios the Bank has followed a simplified approach. This approach consists of applying portfolio level ECL averages, drawn from similar portfolios, where it is not possible to estimate individual parameters. These generally relate to portfolios where specific IFRS 9 models have not been developed due to immateriality, low volumes or where there are no underlying grading models. As granular PDs are not available for these portfolios, a non-standard approach to staging is required with more reliance on the qualitative criteria (along with the 30 days past due back-stop).

iii. Management judgement: Where the estimate of ECL does not adequately capture all available forward looking information about the range of possible outcomes or where there is a significant degree of uncertainty, management judgement may be applied.

The size of the adjustment must consider all relevant and supportable information, including but not limited to, historical data analysis, predictive modelling and management judgement. The methodology to incorporate the adjustment should consider the degree of over collateralisation (headroom) and should not result in a zero overall ECL unless there is sufficient headroom to support this.

*Forms an integral part of the audited financial statements

3.1 Credit risk
Measurement, methodologies and judgements* (continued)

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Risk Management Report (continued)

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Measurement (continued)
Effective interest rate: The ECL must incorporate the time value of money discounted to the reporting date using the effective interest rate ("EIR") determined at initial recognition or an approximation thereof.

- The bank uses an approximation approach based on the account level interest rate when calculating ECL which is applied to both drawn and undrawn commitments.
- This approach is subject to an annual assessment that all proxies remain appropriate and do not result in a material misstatement of the ECL.
- The Bank has tested the appropriateness of using current interest rates as an approximation for the discount rates required for measuring ECLs under IFRS 9. This testing determined that using the current interest rates as the discount rates is an appropriate approximation.

Policy elections and simplifications
Low credit risk exemption
As allowed by IFRS 9, the Bank utilises the practical expedient for the stage allocation of particular financial instruments which are deemed 'low credit risk'. This practical expedient permits the Bank to assume, without more detailed analysis, that the credit risk on a financial instrument has not increased significantly since initial recognition if the financial instrument is determined to have 'low credit risk' at the reporting date. The Bank allocates such assets to Stage 1.

Under IFRS 9 the credit risk on a financial instrument is considered low if:

- the financial instrument has a low risk of default;
- the borrower has a strong capacity to meet its contractual cash flow obligations in the near term; and
- adverse changes in economic business conditions in the longer term may, but will not necessarily, reduce the ability of the borrower to fulfil its contractual cash flow obligations.

This low credit risk exemption is applied to particular assets within the investment debt securities portfolio and for loans and advances to banks. Specifically, assets which have an internal grade equivalent to an external investment grade (BBB-) or higher.

If an asset does not meet the above criteria for the low credit risk exemption, further assessment is required to determine stage allocation. If such assets are on a watch list, they are categorised as Stage 2, otherwise, they are allocated to Stage 1.

Credit risk models
Probability of default
Probability of default ("PD") is the likelihood that an account or borrower defaults over an observation period, given that they are not currently in default. The PD modelling approach uses a combination of rating grades/scores obtained from credit risk models, as outlined on page 13, along with key factors such as the age of an account, the current/recent arrears status or the current/recent forbearance status and macroeconomic factors to obtain the relevant 12 month (Stage 1) and Lifetime (Stage 2) PD.

Loss given default
Loss given default ("LGD") is a current assessment of the amount that will not be recovered in the event of default, taking account of future conditions. It can be thought of as the difference between the amount owed to the Bank (i.e. the exposure) and the net present value of future cash flows less any costs expected to be incurred in the recovery process. If an account returns to performing from default (absent any loss making concession) or if the discounted post-default recoveries are equal to or greater than the exposure, the realised loss is zero.

The LGD modelling approach depends on whether the facility has underlying security and, if so, the nature of that security.

The value of underlying collateral is estimated at the forecasted time of disposal (taking into account forecasted market price growth/falls and haircuts on market values that are expected at the date of sale) in order to calculate the future recovery amount. Estimated costs of disposal are taken into account in this calculation.

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3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Exposure at default
Exposure at default ("EAD") is defined as the exposure amount that will be owed by a customer at the time of default. This will comprise changes in the exposure amount between the reporting date and the date that the customer defaults. This may be due to repayments, interest and fees charged and additional drawdowns by the customer.

Prepayments
For term credit products, prepayment occurs where a customer fully prepays an account prior to the end of its contractual term.

Prepayment is used in the lifetime ECL calculation for Stage 2 loans to account for the proportion of the facilities/customers that prepay each year.

Determining the period over which to measure ECL
The expected maturity is used for assets in Stage 2, where the ECL must be estimated over the remaining life of the facility. The expected maturity approach is:

- Term credit products: the contractual maturity date, with exposure and survival probability adjusted to reflect behaviour i.e. amortisation and pre-payment;

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 and any related ECL will be written off. Expert judgement determines the point at which, there is no reasonable expectation of recovery, e.g. inception of formal insolvency proceedings or receivership/other formal recovery action. This is considered on a case-by-case basis.

Debt forgiveness may subsequently arise where there is a formal contract with the customer for the write-off of the loan. In addition, certain forbearance solutions and restructuring agreements may include an element of debt write down (debt forgiveness).

The Bank recognises cash received from the customer in excess of the carrying value of the loan after a non-contracted write-off as 'recoveries of amounts previously written off' in the income statement.

Macroeconomic scenarios and weightings
The macro-economic scenarios used by the Bank for IFRS 9 purposes is subject to AIB Group's existing governance process covering the development and approval of macro-economic scenarios for planning and stress testing i.e. through Stress Test Working Group and Asset and Liability Committee (ALCo). As outlined above, the parameter models include macro-economic factors as drivers of the risk. Therefore, different ECLs are produced under different macro-economic scenarios. These ECL outcomes are then weighted by the assessed likelihood attaching to each of the different scenarios.

Macro-economic scenarios
AIB Group's approach is to use its base, downside and upside macro-scenarios from the financial planning and stress testing processes for IFRS 9 purposes. The use of current planning scenarios ensures that the scenarios used for IFRS 9 are consistent with the Banks expectations of potential outcomes at a point in time. Non-linear effects are captured in the development of risk parameters as well as through the inclusion of both an upside and a downside case (currently a 'no deal' Brexit which includes a relatively severe impact for the key UK/Republic of Ireland ("ROI") economies). The AIB Economic Research Unit provide base, downside and upside forecasts over 5 years for planning/IFRS 9. The base case is benchmarked against the outlook available from official sources (e.g. Department of Finance, ESRI, IMF, etc.). Upside and downside scenarios are provided representing sensitivities around the base. For IFRS 9 purposes, longer-term projections are sourced from a reputable external provider with the internal base/upside and downside scenarios converging on a linear basis towards the external forecasts from years 5 to 8. External long-term forecasts represent long-term base line forecasts for the parameter/economy in question. The forecasted scenarios are approved on a quarterly basis at AIB ALCo. The scenarios are described below and reflect the views of AIB Group and the Bank at the reporting date.

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Base case: As at the reporting date, this reflects an ‘orderly’ Brexit outcome. This reflects deceleration in Irish house price inflation reflecting rising supply and the impact of the central bank’s macro-prudential rules on mortgage lending. Under this scenario, the Euro-Sterling exchange rate is assumed to gradually rebase to 0.80 by the end of 2020 as a softer Brexit outcome emerges. Growth in the Eurozone is expected to ease back in 2019 and continuing to trend gradually lower thereafter. These developments (in addition to tighter monetary conditions, the absorption of remaining spare capacity in the economy and some slowing due to ‘orderly’ Brexit effects) are reflected in a slight moderation in Irish growth over the horizon.

Downside: Under this scenario, the EU and UK fail to conclude a Withdrawal Agreement. The UK leaves the EU Customs Union and Single Market in March 2019 in a disorderly Brexit and has to apply WTO rules. Irish GDP growth contracts significantly in this period. Brexit results in a sharp decline in trade between the UK and EU as well as an outflow of investment from the UK, especially from the financial sector and a decline in FDI. The ‘no deal’ Brexit has a significant negative impact on the Irish economy with exports to the UK subject to customs checks, tariffs, increased administration and regulatory costs and transport delays. The scenario also includes a further decline in sterling than in the base case.

Taking the expected rise in inward investment into Ireland in a ‘no-deal’ Brexit into account the scenario assumes that Irish GDP growth is lower in a ‘no-deal’ Brexit downside scenario than in our base case over the three years to 2021 although the adverse effects are offset somewhat by an expected rise of inward investment into Ireland (as firms divert new or existing investments away from the UK).

Upside: With continued low interest rates globally, due to subdued inflation and improved productivity from a pickup in investment, growth in advanced economies could strengthen. Emerging markets could also benefit if the improvement in commodity prices and trade continues. A long transition period may be agreed as part of a Brexit withdrawal agreement whereby the UK retains full access to EU markets until a final trade deal is negotiated. Ireland, as a small open economy, benefits due to better than expected export performance. This will ‘spill-over’ to the domestic side of the economy helped by expansionary fiscal policy. There is a strong pick-up in house building helped, in part, by government initiatives. As a result, Irish growth is higher over the 2019-21 planning horizon relative to Base. House price inflation decelerates at a slower pace than in the base case in this environment.

The selection of macroeconomic parameters required and their use in models is determined as part of the Model Development and Governance function for IFRS 9 models. The following table details some of the key macroeconomic variables as they impact the Bank:

Base forecast	2018 (Actual) %	2019 %	2020 %	2021 %	2022 %	2023 %
GDP growth	7.0	4.0	3.5	3.2	3.0	3.0
Residential property price growth	10.3	7.5	5.2	5.0	4.7	4.2
Unemployment rate	5.8	5.2	5.0	4.9	4.8	4.8
Commercial property price growth	2.4	3.9	3.9	3.9	4.0	4.0

Downside forecast	2018 (Actual) %	2019 %	2020 %	2021 %	2022 %	2023 %
GDP growth	7.0	2.25	1.0	1.5	2.5	3.5
Residential property price growth	10.3	5.7	1.7	1.5	3.0	4.0
Unemployment rate	5.8	5.8	6.9	7.7	7.7	7.5
Commercial property price growth	2.4	0.4	-2.4	-1.6	2.0	4.1

Upside forecast	2018 (Actual) %	2019 %	2020 %	2021 %	2022 %	2023 %
GDP growth	7.0	5.0	5.0	5.0	4.0	3.0
Residential property price growth	10.3	8.3	7.7	7.7	8.0	7.0
Unemployment rate	5.8	4.9	4.6	4.4	4.2	4.2
Commercial property price growth	2.4	6.0	7.2	7.7	5.7	3.6

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Macro-economic scenario weightings
The three scenarios detailed above are used to reflect a representative sample of possible outcomes (i.e. base, downside and upside scenarios). The final report ECL allowance reflects a weighted average of the ECLs under the 3 scenarios.

The weights for the scenarios are derived based on the expert judgement informed by a quantitative analysis. The quantitative analysis incorporates two approaches: a statistical analysis informed by both historic patterns in the economic data complemented by a more forward looking approach. These weightings have been reviewed regularly throughout 2018. The weightings have evolved over the year, reflecting both Brexit developments in the UK and uncertain economic conditions internationally. The table below shows the evolution of the weightings throughout 2018.

The scenario weightings are approved on a quarterly basis at AIB Group ALCo.

The weights that have been applied as at the reporting date and approved in January 2019 are:

Scenario	**Weighting**	
	1 January 2018	**31 December 2018**
Base	60%	50%
Downside	20%	35%
Upside	20%	15%

In assessing the adequacy of the ECL provisions, the Bank has considered all available forward looking information as of the balance sheet date in order to estimate the future expected credit losses in line with IFRS 9. The Bank, through its risk management processes (including the use of expert credit judgement and other techniques) assesses its ECL provisions for events that cannot be captured by the statistical models it uses and for other risks and uncertainties. The assessment of ECL at the balance sheet date does not reflect the worst case outcome, but rather a probability weighted outcome of the three scenarios. Should the credit environment deteriorate beyond the Bank's expectation, the Bank's estimate of ECL would increase accordingly.

Sensitivities
The Bank's estimates of expected credit losses are responsive to varying economic conditions and forward looking information. These estimates are driven by the relationship between historic experienced loss and the combination of macroeconomic variables. Given the co-relationship of each of the macroeconomic variables to one another and the fact that loss estimates do not follow a linear path, a sensitivity to any single economic variable is not meaningful. As such, the following sensitivities are provided, based on the aggregate impact of each scenario before the application of probability weights. Relative to the Base scenario, in the 100% Downside scenario, the ECL allowance increases by 14% and in the 100% Upside scenario, the ECL allowance declines by 14%, showing that the ECL impact of the Downside is greater than that of the Upside.

	Loss allowance at 31 December 2018			
Loans and advances to customers	**Reported (50% base, 35% Downside, 15% Upside) Total € m**	**100% Base, 0% Downside, 0% Upside Total € m**	**0% Base, 100% Downside, 0% Upside Total € m**	**0% Base, 0% Downside, 100% Upside Total € m**
Residential mortgages	129	125	143	108
Total	129	125	143	108
Off-balance sheet loan commitments	-	-	-	-
	129	125	143	108

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk (continued)

Measurement, methodologies and judgements* (continued)

Stage 3 PDH mortgage ECL

The Group estimates its ECL allowance based on its historic experience of working out arrangements with customers which predominantly consist of split mortgages, low fixed interest rate, voluntary sale for loss, negative equity trade down and positive equity solutions. This is consistent with the Group's strategy to deliver sustainable long-term solutions and to support customers. In particular, the IFRS 9 Mortgage LGD model which was implemented from 1 January 2018 is based on the actual empirical internal data for such resolved and unresolved cases, and represents the Bank's expected loss based on those current and expected work-out strategies at the time. However, for a cohort of loans that are deep in arrears and/or in a legal process for a significant period of time, it is recognised that alternative recovery strategies may need to be considered. To reflect the range of possible outcomes for this cohort where alternative recovery strategies are required, management judgement has been applied to increase the ECL outcome on transition at 1 January 2018 and at 31 December 2018. As a result, the ECL allowance of €129m for residential mortgages in the Republic of Ireland at 31 December 2018 includes €60m for this management judgement.

Credit profile of the loan portfolio

The Bank's customer loan portfolio comprises of residential mortgages.

The following summarises the key points affecting the credit profile of the loan portfolio at 31 December 2018:

– Non-performing loans reduced from €806m at 31 December 2017 to €558m at 31 December 2018, arises from the implementation of a new definition of default policy, restructuring, write-offs (including non contracted write-offs), repayments and redemptions.
– As at 31 December 2018, 75% of the total loans to customers' portfolio is considered as either strong or satisfactory. The strong/satisfactory portfolio is typically where new business is written, and which would also be impacted by cases upgrading out of criticised due to improved performance.
– There was a total net credit impairment charge of €9m in the 12 months to 31 December 2018. This comprised of credit impairment charge of €13m on loans and advances to customers, and also recoveries of €4m on loans previously written off. For the 12 months to 31 December 2017, which was under IAS 39, there was a provision net charge of €40m.

					2018*
Amortised cost	**Stage 1 € m**	**Stage 2 € m**	**Stage 3 € m**	**POCI € m**	**Total € m**
Strong	2,808	11	-	2	2,821
Satisfactory	265	34	-	-	299
Total strong/satisfactory	**3,073**	**45**	**-**	**2**	**3,120**
Criticised watch	121	179	-	-	300
Criticised recovery	-	197	-	2	199
Total criticised	**121**	**376**	**-**	**2**	**499**
Non-performing	-	-	488	70	558
Gross carrying amount	**3,194**	**421**	**488**	**74**	**4,177**
ECL allowance	(1)	(11)	(109)	(8)	(129)
Total carrying amount	**3,193**	**410**	**379**	**66**	**4,048**

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk (continued)

Credit profile of the loan portfolio

The Bank's customer loan portfolio comprises of residential mortgages. A summarised profile of loans and advances to customers is set out below. Comparative data for 31 December 2017 has been prepared under IAS 39 and the analysis of the asset quality uses the definitions in operation during 2017 which are set out below. Details of the impact of adopting IFRS 9 at 1 January 2018 are set out in note 3 to the financial statements.

The above table outlines the credit profile of the Bank's customer loans portfolio and the relationship with staging outcomes. The credit profile reflects AIB's internal credit grading systems and risk classification.

Of the total loans to customers of €4,048m, €3,120m are rated as either 'strong' or 'satisfactory'. These represent the best performing assets and as a result are primarily in Stage 1 with the lowest ECL allowance requirement. Of the €3,120m, €45m are in Stage 2 due to observed deterioration relative to where the loans originated.

The 'criticised' classification includes 'criticised watch' of €300m and 'criticised recovery' of €199m. Factors considered in identifying criticised cases include a PD of greater than 6.95%, the presence of arrears or cases which have been granted forbearance or downgraded from 'strong' or 'satisfactory' grades.

'Criticised watch' of €300m primarily relates to downgrade activity and as such, there is a strong correlation with Stage 2 and an observed increased in credit risk. Some 'criticised watch' exposures are in Stage 1 due to granting of new lending at 'watch' grades or origination events.

Similarly, the 'criticised recovery' of €199m also has a strong correlation with Stage 2 outcomes as it represents those loans which have recovered from non-performing or which have received forbearance and as such are in Stage 2 reflecting that risk profile.

Non-performing loans amounting to €558m are aligned to the Bank's definition of default and Stage 3 credit impaired with the exception of those originating in Stage 1 or POCI.
The table below sets out the grade of the loan portfolio in 2017

Grade	2017* € m
Satisfactory	**3,777**
Watch	318
Vulnerable	37
Impaired	608
Criticised	**963**
Gross Loans	**4,740**
Provision for loan impairments	(290)
Net Loans	**4,450**

Restructuring

Restructuring the loans of customers in difficulty continues to be a key focus for the Bank. Customer treatment strategies have been developed for customers who are experiencing financial difficulties. The approach is one of structured engagement with co-operating customers to assess their long term levels of sustainable debt.

The reduction in non-performing loans in recent years was largely achieved through case by case restructuring and working with customers to rightsize sustainable debt based on customer affordability alongside strategic deleveraging initiative where appropriate.

For mortgage customers in difficulty, the core objective 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.

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 (and any related ECL allowance) will be written off. Where the loan is secured, the write-off will take account of receipt of the net realisable value of the security held. Partial write-offs, including non-contracted write-offs, may also occur when it is considered that there is no prospect for the recovery of the expected credit loss amount, for example when a loan enters a legal process. The reduced loan balance remains on the balance sheet as non-performing. In addition, write-offs may reflect restructuring activity with customers who are subject to the terms of the revised agreement and subsequent satisfactory performance. In the 12 months to 31 December 2018, write-offs totalled €129m.

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk (continued)

Loans and advances to customers

The following table analyses the Republic of Ireland residential mortgage portfolio showing the ECL allowance at 31 December 2018. Comparative data for 31 December 2017 has been prepared under IAS 39.

	2018*			2017*		
Gross loans and advances to customers	**Owner-Occupier € m**	**Buy-To-Let € m**	**Total € m**	Owner-Occupier € m	Buy-To-Let € m	Total € m
Total gross carrying amount	4,167	10	4,177	4,728	12	4,740
Analysed as to ECL staging						
Stage 1	3,187	7	3,194			
Stage 2	420	1	421			
Stage 3	486	2	488			
POCI	74	-	74			
Analysed by arrears/impaired						
In arrears (> 30 days past due)(1)				633	4	637
In arrears (> 90 days past due)(1)				605	3	608
Of which impaired				605	3	608
Total	**4,167**	**10**	**4,177**			
ECL allowance - statement of financial position	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Stage 1	(1)	-	(1)			
Stage 2	(11)	-	(11)			
Stage 3	(108)	(1)	(109)			
POCI	(8)	-	(8)			
Statement of financial position specific provisions*				(241)	(2)	(243)
Statement of financial position IBNR provisions*				(47)	-	(47)
Total ECL allowance/impairment provisions*	**(128)**	**(1)**	**(129)**	(288)	(2)	(290)
Residential mortgages	**4,038**	**9**	**4,048**	4,440	10	4,450
ECL allowance cover percentage	**%**	**%**	**%**	**%**	**%**	**%**
Stage 1	-	-	-			
Stage 2	3%	7%	3%			
Stage 3	22%	18%	22%			
POCI	10%	78%	10%			
Specific provisions/ impaired loans				39.8	66.7	40.0

(1)Includes all impaired loans whether past due or not.
*Per IAS 39

Income statement credit impairment (writeback)/losses	**2018 € m**	2017 € m
Net remeasurement of loss allowance	13	
Recoveries of amounts written off in previous years	(4)	
Income statement: specific provisions		22
Income statement: IBNR provisions		18
Net credit impairment losses	9	40
	%	**%**
Net credit impairment losses on average loans	0.19	0.78

*Forms an integral part of the audited financial statements

3.1 Credit risk (continued)

ECL allowance – statement of financial position

Under IAS 39, the Bank had total impairment provisions of €290m at 31 December 2017 of which €243m were specific provisions and €47m were IBNR. Upon implementation of IFRS 9 at 1 January 2018 and the introduction of the ECL model, the Bank required an ECL allowance on loans and advances to customers of €245m resulting in a reduction of €45m to the closing stock of provisions at 31 December 2017.

The total ECL cover rate has decreased from 5% at 1 January 2018 to 3% at 31 December 2018, and was primarily driven by noncontracted write-offs in the period and improved business cash flows.

ECL Allowance- Income statement

There was a net credit impairment charge of €9m to the income statement in the year to 31 December 2018, with a charge of €13m and recoveries of €4m on loans previously written off.

Gross loans and ECL movements*

Following the implementation of a new definition of default, which aligns to Stage 3 in IFRS 9 and EBA guidelines, the non-performing exposures ("NPE") stock was revised from €806m at 31 December 2017 to €694m at 1 January 2018 on transition to IFRS 9 with the impact reflected in the opening staging position.

During 2018, the Bank continued to develop and enhance its IFRS 9 ECL modelling methodologies and processes. This includes recalibration and enhancement to take account of updated observed outcomes as well as the full embedding of the definition of default. The results of such recalibrations and model enhancements are reported in 'other movements' below. The movement from Stage 2 to Stage 1 is primarily due to model changes noted above as well as adjustments related to SICR sensitivity where no change in credit quality occurred.

Loans and advances to customers

Residential mortgages gross contractual amounts of €4.2bn at 31 December 2018 compared to gross contractual amounts of €4.7bn at 31 December 2017. The decrease in the portfolio was primarily due to loan repayments and write-offs.

Non-performing loans reduced from €806m at 31 December 2017 to €558m at 31 December 2018, arises from the implementation of a new definition of default policy, restructuring, write-offs (including non contracted write-offs), repayments and redemptions.

The following table analyses the gross carrying amount of loans and advances to customers showing significant changes arising during the year:

					2018
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	€ m	**€ m**	**€ m**	**€ m**	**€ m**
1 January 2018	**3,242**	**750**	**674**	**74**	**4,740**
Impact of adopting IFRS 9					
Transferred from Stage 1 to Stage 2	(179)	179	-	-	-
Transferred from Stage 2 to Stage 1	256	(256)	-	-	-
Transferred to Stage 3	(6)	(47)	53	-	-
Transferred from Stage 3	3	85	(88)	-	-
Other changes in net exposures	(423)	(77)	(42)	-	(542)
Write-offs	-	-	(129)	-	(129)
Derecognised due to disposals	-	-	-	-	-
Interest applied to accounts	93	23	14	-	130
Other movements	208	(236)	6	-	(22)
Gross carrying amount as at 31 December 2018	**3,194**	**421**	**488**	**74**	**4,177**

3.1 Credit Risk

Summary of movements on ECL allowances*

The following table sets out the movements on the ECL allowance on loans and advances to customers at 31 December 2018. Comparative data for 31 December 2017 has been prepared under IAS 39 and shows the movements on impairment provisions.

					2018
	Stage 1 € m	**Stage 2 € m**	**Stage 3 € m**	**POCI € m**	**Total € m**
Loss allowance at 1 January 2018	**2**	**20**	**219**	**4**	**245**
Net remeasurement of ECL allowance-income statement	(1)	(9)	18	5	13
Exchange translation adjustments	-	-	-	-	-
Other movements with no P/L impact					
Changes in loss allowance due to write offs	-	-	(129)	-	(129)
Changes in loss allowance due to disposals	-	-	-	-	-
Other movements	-	-	1	(1)	-
Loss allowance at 31 December 2018	**1**	**11**	**109**	**8**	**129**

Stage transfers are a key component of ECL allowance movements with the net remeasurement cost of moving to a higher stage (i.e. Stage 1 to Stage 2 to Stage 3) being the primary driver of a higher income statement charge (and vice versa).

Transfers from Stage 1 to Stage 2 of €179m represent the underlying credit activity where a significant increase in credit risk occurred at some point during the year through either the quantitative or qualitative criteria for stage movement. The main driver of the movements to Stage 2 was due to the doubling of PDs, subject to 50bps, mainly in the mortgage portfolio. These movements have materially resulted in exposures starting and ending in different stages due to an observed increase in credit risk, however, given the movements represent the cumulative month by month impact, movements to Stage 2 also include those loans that may have subsequently transferred back to Stage 1 (and included in the €256m as outlined below) or further deteriorated to Stage 3 by the end of 2018.

Similarly, transfers from Stage 2 to Stage 1 of €256m represent those loans where the triggers for significant increase in credit risk no longer apply or loans that have fulfilled a probation period. These transfers include loans which have been upgraded through normal credit management process.

Transfers from Stage 2 to Stage 3 of €47m represent those loans that defaulted during the year. These arose in cases where it was determined that the customers were unlikely to pay their credit obligations in full without the realisation of collateral regardless of the existence of any past due amount or the number of days past due. In addition, transfers also include all credit obligors that are 90 days or more past due on a material obligation.

Transfers from Stage 3 to Stage 2 of €85m were driven by resolution activity with the customer, through either restructuring or forbearance, who had subsequently adhered to default probation requirements. As part of the credit management practices, active monitoring of loans and their adherence to default probation requirements is in place. Transfers from Stage 3 to Stage 1 of €3m primarily reflect curing events from default and loans which were fundamentally restructured in the period and which met derecognition criteria.

The caption 'Other changes in net exposures', which contributed €542m to the reduction in exposures, consists mainly of cash repayments.

Write-offs represent the write down of the gross loan balance by the relevant ECL allowance in accordance with the accounting policy. Write-offs due to restructuring activity are also included in this amount.

In summary, the staging movements of the overall portfolio were as follows:

Stage 1 loans reduced by €48m during 2018 with an ECL of €1m and resulting cover of 0.03%. This reduction was primarily on foot on of repayments.

Stage 2 loans decreased by €329m during 2018 with an ECL of €11m and resulting cover of 2.6%. This was due to loans curing to Stage 1, model recalibration and enhancements to the Stage 2 criteria.

Stage 3 exposures decreased by €186m during 2018 with the ECL cover reducing from 32% to 22%. Key drivers were write-off activity of loans with higher ECLs and loans curing to Stage 2.

*Forms an integral part of the audited financial statements

3.1 Credit risk (continued)

Write-offs

The contractual amount outstanding of loans written off during the year that are still subject to enforcement activity amounted to €123m. Write-offs in 2018, as a percentage of gross loans and advances at 1 January 2018, were 2.7%. These include all write-offs, both full and partial and write-offs not contracted with customers.

Residential mortgage arrears

Total loans in arrears (including non-performing loans) by value decreased by 25% during the 12 months to 31 December 2018, a decrease of 25% in the owner-occupier portfolio and a decrease of 32% in the buy-to-let portfolio.

The number of loans in arrears (based on number of accounts) greater than 90 days was 6% at 31 December 2018 and remains below the industry average of 7%[(1)](Q3 2018 latest). For the owner-occupier portfolio, loans in arrears greater than 90 days at 6% were in line with the industry average of 7% (Q3 2018 latest). For the buy-to-let portfolio, loans in arrears greater than 90 days at 29% were higher than the industry average of 15% (Q3 2018 latest).

Forbearance

Residential mortgages subject to forbearance measures decreased by €158m from 31 December 2017 to €640m at 31 December 2018, following a decrease of €209m in the 12 months to 31 December 2017. A key feature of the forbearance portfolio is the level of advanced forbearance solutions (split mortgages, low fixed interest rate, voluntary sale for loss, negative equity trade down and positive equity solutions) driven by the Bank’s strategy to deliver sustainable long-term solutions to customers and support customers in remaining in their family home.

[(1)]Source: Central Bank of Ireland (“CBI”) Residential Mortgage Arrears and Repossessions Statistics as at 30 September 2018, based on numbers of accounts.

3.1 Credit risk (continued)

Loans and advances to customers – Residential mortgages

Actual and weighted average indexed loan to value ratios of Republic of Ireland residential mortgages.

The following table profiles the Republic of Ireland residential mortgage portfolio by the indexed loan-to-value ratios and the weighted average loan-to-value ratios at 31 December 2018.Comparative data for 31 December 2017 has been prepared under IAS 39.

2018*

	At amortised cost														
	Stage 1			**Stage 2**			**Stage 3**			**POCI**			**Overall Total**		
	Owner-Occupier	**Buy-To-Let**	**Total**	**Owner-Occupier**	**Buy-To-Let**	**Total**	**Owner-Occupier**	**Buy-To-Let**	**Total**	**Owner-Occupier**	**Buy-To-Let**	**Total**	**Owner-Occupier**	**Buy-To-Let**	**Total**
	€ m	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**
Less than 50%	1,187	2	1,189	107	-	107	87	-	87	9	-	9	1,390	2	1,392
50% to 70%	897	2	899	128	1	129	97	1	98	22	-	22	1,144	4	1,148
71% to 80%	400	1	401	52	-	52	49	-	49	11	-	11	512	1	513
81% to 90%	308	1	309	46	-	46	42	-	42	12	-	12	408	1	409
91% to 100%	288	1	289	51	-	51	47	-	47	11	-	11	397	1	398
101% to 120%	104	-	104	34	-	34	81	1	82	5	-	5	224	1	225
121% to 150%	1	-	1	2	-	2	62	-	62	1	-	1	66	-	66
Greater than 150%	2	-	2	-	-	-	21	-	21	-	-	-	23	-	23
Total with LTVs	**3,187**	**7**	**3,194**	**420**	**1**	**421**	**486**	**2**	**488**	**70**	**-**	**70**	**4,164**	**10**	**4,174**
Unsecured	-	-	-	-	-	-	-	-	-	3	-	3	3	-	3
Total	**3,187**	**7**	**3,194**	**420**	**1**	**421**	**486**	**2**	**488**	**73**	**-**	**73**	**4,167**	**10**	**4,177**

The weighted average indexed loan-to-value of the stock of residential mortgages at the year end was 63% and stage 3 residential mortgages was 84%.

*Forms an integral part of the audited financial statements

3.1 Credit risk (continued)

Loans and advances to customers – Residential mortgages (continued)
Actual and weighted average indexed loan to value ratios of Republic of Ireland residential mortgages (continued)

2017

	Neither past due nor impaired			Past due and not impaired			>90 days past due and/or impaired		
	Owner-Occupier € m	Buy-To-Let € m	Total € m	Owner-Occupier € m	Buy-To-Let € m	Total € m	Owner-Occupier € m	Buy-To-Let € m	Total € m
Less than 50%	1,194	1	1,195	38	-	38	57	-	57
50% to 70%	1,009	2	1,011	43	-	43	72	-	72
71% to 80%	455	1	456	22	-	22	49	-	49
81% to 90%	440	2	442	16	-	16	51	-	51
91% to 100%	357	1	358	12	-	12	56	-	56
101% to 120%	476	-	476	25	1	26	115	2	117
121% to 150%	29	-	29	5	-	5	125	-	125
Greater than 150%	1	-	1	-	-	-	62	-	62
Unsecured	2	-	2	-	-	-	18	1	19
Total	3,963	7	3,970	161	1	162	605	3	608

3.1 Credit risk (continued)

Non-performing exposures ("NPE") to customers

The internal credit ratings profile of loans and advances to customers is described on page 13. This sets out the basis on which the Bank manages its credit portfolio. In addition, the Bank's off-balance sheet commitments are set out below.

The non-performing exposures ("NPE") stock was revised from €806m at 31 December 2017 to €694m at 1 January 2018 reflecting the implementation and harmonisation of a new definition of default policy which aligns to accounting standards and EBA guidelines.

The table below further analyses non-performing loans and advances to customers by asset class at 31 December 2018. Comparative data for 31 December 2017 has been prepared under IAS 39 and uses the internal ratings methodology in operation at that time.

Non-performing loans

	2018
	Total
Residential Mortgages	**€ m**
At amortised cost	
Collateral disposals	**3**
Unlikely to pay (including > 90 days past due)	**469**
Non-performing loans probation	**86**
Total gross carrying amount at amortised cost	**558**
Non-performing loans as % of total loans and advances to customers	**13%**

The non-performing exposures ("NPE") stock decreased from €694m at 1 January 2018 to €558m at 31 December 2018 being 13% and 13% respectively of total loans and advances to customers.

Continued momentum in 2018 in reducing the stock of non-performing loans resulted in in the quantum of defaulted loans reducing by €136m in the 12 months to 31 December 2018 (a decrease of 20%). This reduction was achieved through redemptions and repayments from customers, restructuring activity including non-contracted write-offs and asset sales/disposals.

Total non-performing off-balance sheet commitments

Total non-performing off-balance sheet commitments amounted to Nil.

*Forms an integral part of the audited financial statements

Risk Management Report (continued)

3.1 Credit risk

The number (stock) of properties in possession at 31 December 2018 and 2017 is set out below:

	2018		2017	
	Stock	**Balance outstanding € m**	Stock	Balance outstanding € m
Owner-Occupier	**162**	**42**	176	45
Buy-To-Let	**1**	**-**	1	-
Total	**163**	**42**	177	45

The stock of residential properties in possession decreased by 14 properties in 2018. This decrease relates to the disposal of 13 properties (2017: 62 properties) which were offset by the addition of 9 properties (2017: 28 properties), the majority of which were voluntary surrenders or abandonments. In addition, a further 10 properties were removed from the stock in 2018, mainly due to cases where a restructure arrangement has been agreed with the customer.

The disposal of 13 residential properties in the Republic of Ireland resulted in a total loss on disposal of €2m in 2018 (before loss allowance) and compares to 2017 when 62 residential properties were disposed of resulting in a total loss of €8m. Losses on the sale of such properties are recognised in the income statement as part of the net credit impairment losses.

The following table analyses the disposals of repossessed properties for the years ended 31 December 2018 and 2017:

	2018					
	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	**13**	**3**	**2**	**-**	**2**	**171%**
Buy-To-Let	**-**	**-**	**-**	**-**	**-**	
Total residential	**13**	**3**	**2**	**-**	**2**	**171%**

[1] Before specific impairment provisions.

	2017					
	Number of disposals	Balance outstanding at repossession € 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%

3.2 Restructure execution risk

A restructure execution risk exists whereby EBS's restructuring activity may not be executed in line with Management's expectations. EBS has reduced its non-performing loans from €806m at December 2017 to €558m as at 31 December 2018. A significant element of this reduction has been achieved by working with customers in difficulty to deliver sustainable solutions based on a wide range of customer restructuring options. This approach has materially improved the Group's asset quality, and lowered the overall credit risk profile. EBS continues to implement solutions for customers who fully engage.

Criticised and non-performing loans are managed through the restructuring lifecycle in line with the AIB's credit strategies, policies, and implementation guidelines. A wide range of monitoring procedures are in place to manage loan portfolios, including restructured loans. AIB regularly reviews the performance of these loans through dedicated teams who focus on asset sales, covenants and milestones within the restructured portfolio. The reduction of non-performing loans continues to be a key focus for EBS and AIB going forward.

3.3 Funding and liquidity risk

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

The objective of liquidity management is to ensure that, at all times, 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").

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 to the Board on developments on a regular basis.

3.3 Funding and liquidity risk (continued)

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 Executive Committee 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 which comprises the Group's Finance department. 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, reporting to the CFO, 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, is responsible for exercising independent risk oversight 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 Risk Framework and supporting 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.

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.

*Forms an integral part of the audited financial statements.

3.3 Funding and liquidity risk (continued)
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 Group Risk Committee ("GRC"), AIB Board Risk Committee ("BRC"), the AIB Executive Committee ("ExCo") and the AIB Board.

Liquidity risk stress testing

Stress testing is a key component of the liquidity risk management framework and ILAAP. The Bank as part of AIB is included in the 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 Executive Committee 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 Bank.

2018

	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	**729**	**-**	**-**	**-**	**-**	**729**
Derivative financial instruments	**-**	**-**	**-**	**-**	**23**	**23**
Debt securities in issue	**-**	**-**	**-**	**1,500**	**1,038**	**2,538**
Total	**729**	**-**	**-**	**1,500**	**1,061**	**3,290**

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

*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 68% at 31 December 2018 (2017: 52%). 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 business and financial 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 the reporting pack is presented to senior executive and Board Committees setting out the evolution of AIB's capital position. AIB Group Board reviews and approves the Group ICAAP (incorporating the Bank) 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 four macro interest rate swaps with EBS dac, three of which, the Pool Hedge swaps, 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 EBS dac 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 centrally to Treasury and Capital & Liquidity for management, subject to review and oversight by AIB Group 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 Group ALCo, which incorporate forward-looking measures such as VaR limits and stress test limits and financial measures such embedded value limits. AIB Treasury and Capital & Liquidity document an annual Risk Strategy and Appetite Statement as part of the annual financial planning cycle which ensures AIB'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 2018 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 advances to customers	3,392	20	145	193	227	24	176	-	(129)	4,048
Loans and advances to banks	75	-	-	-	-	-	-	-	-	75
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	23	23
Other assets	-	-	-	-	-	-	-	-	2	2
Total Assets	**3,467**	**20**	**145**	**193**	**227**	**24**	**176**	**-**	**(104)**	**4,148**
Liabilities										
Deposits by banks	729	-	-	-	-	-	-	-	-	729
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	23	23
Debt issued	2,538	-	-	-	-	-	-	-	-	2,538
Other liabilities	-	-	-	-	-	-	-	-	7	7
Shareholders' equity	-	-	-	-	-	-	-	-	851	851
Total Liabilities	**3,267**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**881**	**4,148**
Derivatives financial instruments										
(interest rate swaps)										
Floating rate interest receivable	(4,219)	-	-	-	-	-	-	-	-	(4,219)
Floating rate interest payable	3,434	20	145	193	227	24	176	-	-	4,219
Total derivatives	**(785)**	**20**	**145**	**193**	**227**	**24**	**176**	**-**	**-**	**-**
Interest sensitivity gap	**985**	**-**	**-**	**-**	**-**	**-**	**-**	**-**	**(985)**	**-**
Cumulative interest sensitivity gap	**985**	**985**	**985**	**985**	**985**	**985**	**985**	**985**		**-**

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 2018 would be circa -€2m/€2m 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 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 advances to customers	4,179	32	243	68	132	46	34	5	(289)	4,450
Loans and advances 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	234	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 -€2m/€2m** respectively.

*Forms an integral part of the audited financial statements.
**Restated due to a change in methodology

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 includes Information Technology, Cyber, Change, Continuity Management, Outsourcing & Cloud, Products, People & Property Protection and Legal risks.

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 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 within AIB is to provide a timely and pertinent update of the Operational Risk Profile, in order to assist senior management in discharging their responsibility for the oversight of risk. A secondary objective is to provide management with an overview of the Operational Risk profile, in order to support the effective management of risks.

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

3.7 Regulatory compliance risk including conduct risk

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

The level of regulatory risk remained high in 2018 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 2018, projects were mobilised within AIB Group to prepare for the significant regulatory change horizon.

Although 2019 will see a move to regulators and supervisors assessing how recent key regulatory requirements have been implemented, the level of regulatory change is expected to remain at high levels in 2019 and beyond.

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 Group Conduct Risk Framework, aligned with AIB Strategy, is embedded in the organisation and provides oversight of conduct risks at Executive Committee and Board level. This includes the embedding of a customer centric culture aligned to AIB's Brand Values and Code of Conduct, the promotion of good conduct throughout the organisation.

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 Group.

*Forms an integral part of the audited financial statements.

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 the 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.

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. The EBSMF Financial Plans are reviewed and approved by the EBSMF Boards.

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

Performance against plan is monitored at Bank level by the Bank's executive management and Board on a quarterly basis. At an overall AIB level, performance against plan is monitored as part of the AIB CFO Report which is discussed at the AIB Leadership Team/Executive Committee and Board on a monthly basis. Risk profile against risk appetite measures, some of which reference performance against plan, is monitored by the CRO and reported on a monthly basis to the Executive Risk Committee and Board. EBS MF separately monitor the Risk profile against risk appetite measures for EBS MF and reported on a monthly basis to the Subsidiary Board and to the Group Risk Function.

*Forms an integral part of the audited financial statements.

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.

As a material risk, the status of model risk is reported on a monthly basis in the AIB CRO 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 Euronext Dublin, 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,

Helen Dooley
Chair

Chris Curley
Managing Director

DATE: 26 MARCH 2019

Independent Auditor's 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 'Bank')

In our opinion the Bank financial statements:

- give a true and fair view of the assets, liabilities and financial position of the Bank as at 31 December 2018 and of the profit for the financial year then ended; and
- have been properly prepared in accordance with the relevant financial reporting framework and, in particular, with the requirements of the Companies Act 2014.

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 29, including a summary of significant accounting policies as set out in note 1.

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

Basis for 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 Bank 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 matter that we identified in the current year was: • Expected credit losses on loans and advances to customers. Within this report, any new key audit matters are identified with ⮝ and any key audit matters which are the same as the prior year are identified with ≫
Materiality	We determined materiality for the Bank to be €9m which is 9% of profit before tax excluding amounts payable to EBS d.a.c. (note 10).
Significant changes in our approach	On 1 January 2018, the Bank transitioned to the financial instruments accounting standard IFRS 9 which replaced IAS 39. Under the new impairment model, losses on financial assets which are recognised as amortised cost are recognised on an expected credit loss basis. As result we have identified a new key audit matter, *'Expected credit losses on loans and advances to customers'.*

Independent Auditor's Report to the members of EBS Mortgage Finance (continued)

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 Bank'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.

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.

Expected credit losses on loans and advances to customers	
Key audit matter description	On 1 January 2018, the Bank transitioned to financial instruments accounting standard IFRS 9 which replaced IAS 39. Under the new impairment model, losses on assets which are classified at amortised cost are recognised on an expected credit loss basis. Expected credit losses ("ECL") are required to incorporate forward looking information, reflecting Management's view of potential future economic environments. The complexity involved in the calculations required Management to develop new methodologies involving the use of significant judgements. In order to meet the requirements of the new standard, significant changes have also been made to systems, processes and controls with effect from 1 January 2018. Management have availed of the option within IFRS 9 to apply the standard prospectively. Information regarding the transitional effect of IFRS 9 is disclosed in note 3, including the impact on shareholders' equity at 1 January 2018. Expected credit loss allowances on loans and advances to customers was €129m at 31 December 2018 (€245m at 1 January 2018). Measurement of the ECL allowances on loans and advances to customers is a key audit matter as the determination of assumptions for ECLs is highly subjective due to the level of judgement applied by Management. The most significant judgements include: • Determining the criteria for a significant increase in credit risk, ("SICR") and for being classified as credit impaired; • Accounting interpretations and assumptions used to build the models that calculate the ECL; • The determination of key assumptions, including collateral valuation and cashflow timings, used in discounted cash-flows ('DCFs') of individually assessed loans. DCFs are the most significant input to the ECL calculation for Stage 3 loans; • The completeness and accuracy of data used to calculate the ECL; • The completeness and valuation of post model adjustments determined by Management for certain higher risk portfolio's and to address known model limitations; and • Establishing the number and relative weightings for forward looking macroeconomic scenarios applied in measuring the ECL. This is highly subjective given that such assumptions are subject to significant uncertainty related to future economic outcomes, including the impact of Brexit. This results in a wide range of possible outcomes. Please also refer to pages 66 to 68] (Accounting Policy 1.9 – Impairment of financial assets), Note 2 – Critical accounting judgements and estimates, Note 3 – Transition to IFRS 9, Note 10 – Net credit impairment writeback/(losses) and Note 15 – Loans and advances to customers.

Independent Auditor's Report to the members of EBS Mortgage Finance (continued)

<table>
<tr>
<td>How the scope of our audit responded to the key audit matter</td>
<td>
We tested key controls supporting the calculation of ECLs on loan and advances to customers focusing on:
– model development, validation and approval to ensure compliance with IFRS 9 requirements;
– review and approval of key assumptions, judgements and macro-economic forward looking information used in the models;
– the integrity of data used as input to the models including the transfer of data between source systems and the ECL models;
– the application of SICR criteria and default definition used to determine stage outcomes.
– governance and approval of post model adjustments recorded by Management;
– governance and approval of the output of IFRS 9 models; and
– front line credit monitoring and assessment controls including annual case file reviews.

Our testing included an evaluation of the design and implementation of these key controls. Where control deficiencies were identified we tested compensating controls implemented to produce the ECLs and financial statement disclosures. We also assessed Management review controls and governance controls including attendance and observation of AIB Group Board Risk Committee and Credit Committee meetings

We evaluated IT system controls including assessing data inputs and new controls which were implemented for IFRS 9. We tested the completeness and accuracy of key data inputs and reconciled to source systems where appropriate.

We critically assessed the ECL models developed by the Bank. In conjunction with Deloitte credit modelling specialists we assessed judgements and assumptions supporting the ECL requirements of the standard. These included assumptions used in the ECL models applied in stage allocation, calculation of lifetime probability of default and methods applied to derive loss given default rates. We evaluated the methodology and performed code reviews for a sample of models.

We assessed the reasonableness of forward looking information incorporated into the impairment calculations including assessing Management's experts. We challenged the macroeconomic scenarios chosen and the weighting applied to capture non-linear losses. This included benchmarking the economic data used to recognised external data sources. We also considered the impact of key uncertainties including Brexit.

We considered post-model adjustments, applied by Management to address model and data limitations. We challenged the rationale for these adjustments and performed testing on their calculation.

We considered significant items impacting the ECL allowance balance. This included portfolio sales and non-contracted write-offs as well as recoveries on amounts previously written off.

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 ECL allowances and the sensitivity of the allowance to changes in the underlying assumptions.

Based on the evidence obtained, we found that the data and assumptions used by management in determining ECLs on loans and advances to customers are within a range we consider to be reasonable.
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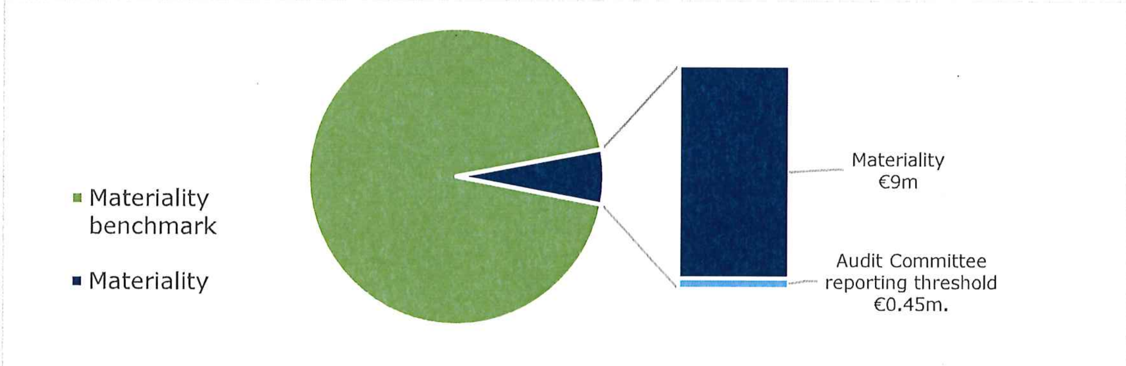
Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above, and we do not express an opinion on these individual matters.

Independent Auditor's Report to the members of EBS Mortgage Finance (continued)

Our application of materiality

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

We determined materiality for the Bank to be €9m which is 9% of profit before tax excluding amounts payable to EBS, d.a.c. (note 9) ('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 Bank and the reliability of control environment.



We agreed with the Board that we would report to them any audit differences in excess of €0.45m, as well as differences below that threshold which, in our view, warranted reporting on qualitative grounds. We also report to the Board 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 Bank and its environment, including the controls operating within the Bank, and assessing the risks of material misstatement related to the financial statements of the Bank. 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 Auditor's Report to the members of EBS Mortgage Finance (continued)

Responsibilities of 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 Bank'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 Bank 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 Bank'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 Bank'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 Group) 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.

For listed entities and public interest entities, the auditor also provides those charged with governance with a statement that the auditor has complied with relevant ethical requirements regarding independence, including the Ethical Standard for Auditors (Ireland) 2016, and communicates with them all relationships and other matters that may be reasonably be thought to bear on the auditor's independence, and where applicable, related safeguards.

Where the auditor is required to report on key audit matters, from the matters communicated with those charged with governance, the auditor determines those matters that were of most significance in the audit of the financial statements of the current period and are therefore the key audit matters. The auditor describes these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, the auditor determines that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

EBS

Independent Auditor's Report to the members of EBS Mortgage Finance (continued)

This report is made solely to the Bank'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 Bank'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 Bank and the Bank's members as a body, for our audit work, for this report, or for the opinions we have formed.

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 Bank were sufficient to permit the financial statements to be readily and properly audited.
- The Bank 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 and 4 that:

- In our opinion, based on the work undertaken during the course of the audit, the information given in the Corporate Governance Statement pursuant to subsections 2(c) of section 1373 Companies Act 2014 is consistent with the Bank's statutory financial statements in respect of the financial year concerned and such information has been prepared in accordance with the Companies Act 2014. Based on our knowledge and understanding of the Bank and its environment obtained in the course of the audit, we have not identified any material misstatements in this information.

Matters on which we are required to report by exception

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

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

Other matters which we are required to address

Following the recommendation of the Audit Committee of EBS Mortgage Finance, we were appointed at the Annual General Meeting on 30 July 2013 to audit the financial statements for the financial year ended 31 December 2013. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 6 years, covering the years ending 2013 to 2018.

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

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

Sinéad Moore

Sinéad Moore
For and on behalf of Deloitte Ireland LLP
Chartered Accountants and Statutory Audit Firm
Deloitte & Touche House, Earlsfort Terrace, Dublin 2

Date: 26 March 2019 .

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 2018

	Note	2018 € m	2017 € m
Interest income calculated using the effective interest method	4	**133**	180
Interest expense and similar charges	5	**(11)**	(15)
Net interest income		**122**	165
Net trading income	6	**2**	2
Net gain on other financial assets measured at FVTP	7	**1**	-
Other operating income	8	**-**	1
Total operating income		**125**	168
Administrative expenses	9	**(71)**	(98)
Operating profit before provisions		**54**	70
Net credit impairment charge	10	**(9)**	(40)
Operating profit before taxation		**45**	30
Income tax charge	11	**(6)**	(4)
Profit for the year		**39**	26

The operating profit arises from continuing operations.

Statement of Comprehensive Income

For the financial year ended 31 December 2018

	2018 € m	2017 € m
Profit for the year	**39**	26
Other comprehensive income for the year	**-**	-
Total comprehensive income for the year	**39**	26

The notes on pages 58 to 96 are an integral part of these financial statements.

Statement of Financial Position

As at 31 December 2018

	Note	31 Dec 2018	01 Jan 2018[(1)]	31 Dec 2017
		€ m	€ m	€ m
Assets				
Non-current asset held for sale	12	**2**	1	1
Derivative financial instruments	13	**23**	20	20
Loans and advances to banks	14	**75**	69	69
Loans and advances to customers	15	**4,048**	4,495	4,450
Prepayments and accrued income		**-**	1	1
Total assets		**4,148**	4,586	4,541
Liabilities				
Deposits by banks	17	**729**	1,723	1,723
Derivative financial instruments	13	**23**	20	20
Debt securities in issue	18	**2,538**	2,022	2,022
Deferred tax liabilites	16	**4**	6	-
Accruals and deferred income		**3**	-	-
Provisions for liabilities and commitments	19	**-**	1	1
Other liabilities		**-**	2	2
Total liabilities		**3,297**	3,774	3,768
Shareholders' equity				
Issued share capital presented as equity	20	**552**	552	552
Revenue reserves		**299**	260	221
Shareholders' equity		**851**	812	773
Total liabilities and shareholders' equity		**4,148**	4,586	4,541

(1) The 'Statement of financial position' as at 1 January 2018 reflects the adoption of IFRS 9 which apply with effect from 1 January 2018.See 'Basis of preparation' in note 1.3.

The notes on pages 58 to 96 form an integral part of these financial statements.

Helen Dooley
Chair

Chris Curley
Managing Director

Gerry Gaffney
Director

Diane Lumsden
Secretary

DATED: 26 MARCH 2019

Statement of Cash Flows

For the financial year ended 31 December 2018

	Note	2018 €m	2017 €m
Cash flows from operating activities			
Operating profit before taxation		**45**	30
Adjusted for - Impairment of loans and advances to customers	10	**9**	40
Fair value movement on trading item		**-**	1
		54	71
Changes in operating assets and liabilities			
Change in loans and advances to customers	15	**433**	390
Change in accrual and deferred income		**3**	-
Change in provisions for liabilities and commitments	19	**(1)**	(13)
Change in other liabilities		**2**	
Change in prepayments and accrued income		**-**	1
Net cash flows from operations before taxation		**491**	449
Taxation paid		**(7)**	-
Net cash flows from operations		**484**	449
Net cash flow from investing activities		**-**	-
Cash flow from financing activities			
Issue of debt securities		**516**	522
Redemption of debt securities		**-**	-
Change in deposits by banks	17	**(994)**	(951)
Net cash flows from financing activities		**(478)**	(429)
Net decrease in cash and cash equivalents		**6**	20
Cash and cash equivalents at 1 January		**69**	49
Cash and cash equivalents at 31 December	22	**75**	69

The notes on pages 58 to 96 are an integral part of these financial statements.

Statement of Changes in Shareholders' Equity

For the financial year ended 31 December 2018

	Ordinary Share Capital € m	Revenue Reserves € m	Total Shareholders' Equity € m
At 31 December 2017	**552**	**221**	**773**
Impact of adopting IFRS 9 at 1 January 2018	-	**39**	**39**
Restated balance at 1 January 2018	**552**	**260**	**812**
Total comprehensive income for the financial year	**-**	**39**	**39**
At 31 December 2018	**552**	**299**	**851**
At 1 January 2017	552	195	747
Total comprehensive income for the financial year	-	26	26
At 31 December 2017	552	221	773

Notes to the Financial Statements

Notes to the Financial Statements (continued)

ACCOUNTING POLICIES INDEX

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- **1.3** Basis of preparation
- **1.4** Interest income and expense recognition
- **1.5** Net trading income
- **1.6** Financial assets
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- **1.8** Derivatives and hedge accounting
- **1.9** Impairment of financial assets
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- **1.15** Non-current asset held for sale
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Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES

The accounting policies applied in the preparation of the financial statements for the financial year ended 31 December 2018 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 periods commencing on or after 1 January 2018. The accounting policies have been consistently applied by the Bank and are consistent with the previous year, apart from policies adopted as a result of the implementation of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* which are outlined below.

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 Euronext Dublin.

1.3. Basis of preparation

Functional and presentation currency

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

Basis of measurement

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

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 a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of expected credit losses on financial instruments; determination of the fair value of certain financial assets and financial liabilities; and provisions for liabilities and commitments.

A description of these judgements and estimates is set out in 'Critical accounting judgements and estimates' on pages 73 to 74.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.3. Basis of preparation (continued)

Going Concern
The financial statements for the financial year ended 31 December 2018 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.

First time adoption of new accounting standards
On 1 January 2018, the Bank implemented the requirements of IFRS 9 *Financial Instruments* and IFRS 15 *Revenue from Contracts with Customers* for the first time.

Comparative data for 2017 was prepared under IAS 18 *Revenue* and IAS 39 *Financial Instruments: Recognition and Measurement.*

IFRS 9 Financial Instruments
The effective date for IFRS 9 *Financial Instruments* was 1 January 2018 and was adopted by the Bank on that date. 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, any difference arising between IFRS 9 carrying amounts and IAS 39 carrying amounts at 1 January 2018 are recognised in opening retained earnings (or in other comprehensive income, as applicable).

The Bank applied IFRS 9 as issued in 2014 at 1 January 2018 and early adopted the amendments to IFRS 9 on the same date.

Since the Bank is continuing to apply IAS 39 hedge accounting requirements as allowed by IFRS 9, there has been no change to the 'derivatives and hedge accounting policy' – Accounting policy 1.8.

IFRS 9 *Financial Instruments* replaced IAS 39 *Financial Instruments: Recognition and Measurement*. IFRS 9 includes a revised classification and measurement model for financial assets, a forward looking expected credit loss impairment methodology and modifies the approach to hedge accounting.

The business model assessment test required by IFRS 9 was performed as at the date of initial application. This classification applies 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.

The impact net of tax on transition to IFRS 9 was €39m representing an increase in revenue reserves and other comprehensive income, principally due to the impairment requirements.

Further details on the impact of adopting IFRS 9 are set out in note 3 to these financial statements.

IFRS 9 accounting policies
The more significant accounting policies for the Bank under IFRS 9 are:

a) Recognition and initial measurement; accounting policy 1.6
b) Classification and subsequent measurement; accounting policy 1.6
c) Interest income and expense recognition; accounting policy 1.4
d) Derecognition; accounting policy 1.9, and
e) Impairment of financial assets accounting policy 1.9

A summary of these policies is set out below under the relevant headings.

IFRS 15 Revenue from Contracts with Customers
The effective date for IFRS 15 *Revenue from Contracts with Customers* was 1 January 2018 and was adopted by the Bank on that date by recognising the cumulative effect of initially adopting the standard as an adjustment to the opening balance of retained earnings.

1. ACCOUNTING POLICIES (continued)

1.3. Basis of preparation (continued)

IFRS 15 Revenue from Contracts with Customers (continued)
IFRS 15 replaces all existing revenue recognition requirements in IFRS and applies to all revenue arising from contracts with customers unless the contracts are within the scope of other accounting standards.

The standard outlines the principles entities must apply to measure and recognise revenue with the core principle being that entities should recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled to in exchange for fulfilling its performance obligations to a customer.

IFRS 15 had no material impact on the Bank on initial adoption.

1.4 Interest income and expense recognition
Interest income and expense is recognised in the income statement using the effective interest method.

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

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

Amortised cost and gross carrying amount
The amortised cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

The gross carrying amount of a financial asset is the amortised cost before adjusting for any loss allowance.

Calculation of interest income and interest expense
In calculating interest income and expense, the effective interest rate is applied to the gross carrying amount of the asset (when the asset is not credit impaired) or to the amortised cost of the liability.

For financial assets that have become credit impaired subsequent to initial recognition, interest income is calculated by applying the effective interest rate to the amortised cost of the financial asset. If the asset is no longer credit impaired, the calculation of interest income reverts to the gross basis.

However, for financial assets that were credit impaired on initial recognition, interest income is calculated by applying the credit adjusted effective interest rate to the amortised cost of the financial asset. The calculation of interest income does not revert to a gross basis even if the credit risk of the asset improves.

When a financial asset is no longer credit impaired or has been repaid in full (i.e. cured without financial loss), the Bank presents previously unrecognised interest income as a reversal of credit impairment/recovery of amounts previously written-off. (The Bank's policy prior to the adoption of IFRS 9 on 1 January 2018 was to recognise such income in interest income). Interest income and expense on financial assets and liabilities classified as held for trading or at FVTPL is recognised in 'other interest income and similar income' or 'interest expense' on the income statement, as applicable.

Presentation
Interest income and expense presented in the income statement include:
– Interest on financial assets and financial liabilities measured at amortised cost calculated on an effective interest basis;
– Interest on financial assets measured at FVTPL;
– Net interest income and expense on qualifying hedge derivatives or fair value hedges which are recognised in interest income or interest expense; and
– Interest income and funding costs of trading portfolio financial assets.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.5. Net trading income
Net trading income comprises gains less losses relating to trading assets and liabilities, and includes all realised and unrealised fair value changes. Interest revenue and dividend income on trading assets are shown in 'interest income' and 'dividend income' respectively.

1.6. Financial assets

Recognition and initial measurement
The Bank initially recognises financial assets on the trade date, being the date on which the Bank commits to purchase the assets. Loan assets are recognised when cash is advanced to borrowers.

Financial assets measured at amortised cost or at fair value through other comprehensive income ("FVOCI") are recognised initially at fair value adjusted for direct and incremental transaction costs. Financial assets measured at fair value through profit or loss ("FVTPL") are recognised initially at fair value and transaction costs are taken directly to the income statement.

Derivatives are measured initially at fair value on the date on which the derivative contract is entered into. 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.

Classification and subsequent measurement
On initial recognition, a financial asset is classified and subsequently measured at amortised cost, FVOCI or FVTPL.
The classification and subsequent measurement of financial assets depend on:
– The Bank's business model for managing the asset; and

– The cash flow characteristics of the asset (for assets in a 'hold-to-collect' or 'hold-to-collect-and-sell' business model).

Based on these factors, the Bank classifies its financial assets into one of the following categories:

– Amortised cost
Assets that have not been designated as at FVTPL, and are held within a 'hold-to-collect' business model whose objective is to hold assets to collect contractual cash flows; and whose contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest. The carrying amount of these assets is calculated using the effective interest method and is adjusted on each measurement date by the expected credit loss allowance for each asset, with movements recognised in profit or loss.

– Fair value through other comprehensive income ("FVOCI")
Assets that have not been designated as at FVTPL, and are held within a 'hold-to-collect-and-sell' business model whose objective is achieved by both collecting contractual cash flows and selling financial assets; and whose contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest ("SPPI"). Movements in the carrying amount of these assets are taken through other comprehensive income ("OCI"), except for the recognition of credit impairment gains or losses, interest revenue or foreign exchange gains and losses, which are recognised in profit or loss. When a financial asset is derecognised, the cumulative gain or loss previously recognised in OCI is reclassified from equity to profit or loss.

– Fair value through profit or loss ("FVTPL")
Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. Gains or losses on such assets are recognised in profit or loss on an on-going basis.
In addition, the Bank may irrevocably designate a financial asset as at FVTPL that otherwise meets the requirements to be measured at amortised cost or at FVOCI if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

– Embedded derivatives
Certain hybrid contracts may contain both a derivative and a non-derivative component, an 'embedded derivative'. Under IFRS 9, there is no bifurcation of embedded derivatives from the host financial asset. As a result, financial assets with embedded derivatives will generally fail the SPPI test unless the embedded derivative does not substantially modify the cash flows that would otherwise be required by the contract. Those failing the SPPI test will be classified and measured at FVTPL.

1. ACCOUNTING POLICIES (continued)

1.6. Financial assets (continued)

– Business model assessment

The Bank makes an assessment of the objective of the business model at a portfolio level, as this reflects how portfolios of assets are managed to achieve a particular objective, rather than management's intentions for individual assets.
The assessment considers the following:

- The strategy for the portfolio as communicated by management;
- How the performance of the portfolio is evaluated and reported to senior management;
- The risks that impact the performance of the business model, and how those risks are managed;
- How managers of the business are compensated (i.e. based on fair value of assets managed or on the contractual cash flows collected); and
- The frequency, value and timing of sales in prior periods, reasons for those sales, and expectations of future sales activity.
- Financial assets that are held for trading or managed within a business model that is evaluated on a fair value basis are measured at FVTPL because the business objective is neither hold-to-collect contractual cash flows nor hold-to-collect-and-sell contractual cash flows.

– Characteristics of the contractual cash flows

An assessment ('SPPI test') is performed on all financial assets at origination that are held within a 'hold-to-collect' or 'hold-to-collect and- sell' business model to determine whether the contractual terms of the financial assets give rise on specified dates to cash flows that are solely payments of principal and interest on the principal outstanding. For the purposes of this assessment, 'principal' is defined as the fair value of the financial asset at initial recognition. 'Interest' is defined as consideration for the time value of money, for the credit risk associated with the principal amount outstanding, and for other basic lending risks and costs (i.e. liquidity, administrative costs), and profit margin.

The SPPI test requires an assessment of the contractual terms and conditions to determine whether a financial asset contains any terms that could modify the timing or amount of contractual cash flows of the asset, to the extent that they could not be described as solely payments of principal and interest. In making this assessment, the Bank considers:

- Features that modify the time value of money element of interest (e.g. tenor of the interest rate does not correspond with the frequency within which it resets);
- Terms providing for prepayment and extension;
- Leverage features;
- Contingent events that could change the amount and timing of cash flows;
- Terms that limit the Bank's claim to cash flows from specified assets; and
- Contractually linked instruments.

Contractual terms that introduce exposure to risks or volatility in the contractual cash flows that are unrelated to a basic lending arrangement, do not give rise to contractual cash flows that are solely payments of principal and interest on the principal amount outstanding.

– Reclassifications

Reclassifications of financial assets to alternative asset categories, (e.g. from amortised cost to FVOCI), should be very infrequent, and will only occur if the Bank decides to make a fundamental change in its business model for managing a specific portfolio of financial assets. This election is made on an instrument-by-instrument basis. When this election is used, fair value gains and losses are recognised in OCI and are not subsequently reclassified to profit or loss on derecognition of the equity instrument.

1.7. Financial liabilities

The Bank categorises financial liabilities as at amortised cost or as at fair value through profit or loss.

The Bank recognises a financial liability when it becomes party to the contractual provisions of the contract.

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.

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

1. ACCOUNTING POLICIES (continued)

1.7. Financial liabilities (continued)

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

1.8. Derivatives and hedge accounting

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

Derivatives

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

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

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

Hedging

The Bank has opted to remain with the IAS 39 hedge accounting requirements until macro hedge accounting is addressed by the IASB as part of a separate project. This is an accounting policy choice allowed by IFRS 9.

All derivatives are carried at fair value and the accounting treatment of the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. Where derivatives are held for risk management purposes, and where transactions meet the criteria specified in IAS 39 *Financial Instruments: Recognition and*

Measurement, the Bank designates certain derivatives as either:

- hedges of the fair value of recognised assets or liabilities or firm commitments (‘fair value hedge’); or
- hedges of the exposure to variability of cash flows attributable to a recognised asset or liability, or a highly probable forecasted transaction (‘cash flow hedge’); or
- hedges of a net investment in a foreign operation.

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

The Bank discontinues hedge accounting when:

a) it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;

b) the derivative expires, or is sold, terminated, or exercised;

c) the hedged item matures or is sold or repaid; or

d) a forecast transaction is no longer deemed highly probable.

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

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

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.8. Derivatives and hedge accounting (continued)

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 that do not qualify for hedge accounting

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

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

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

1.9. Impairment of financial assets

The Bank recognises loss allowances for expected credit losses at each balance sheet date for the following financial instruments that are not measured at FVTPL:

- Financial assets at amortised cost;
- Financial assets at FVOCI (except for equity instruments);
- Loan commitments issued.

ECLs are the weighted average of credit losses with the respective risks of a default occurring as the weights. These are an estimate of credit losses over the life of a financial instrument. When measuring ECLs, the Bank takes into account:

- probability-weighted outcomes;
- the time value of money so that ECLs are discounted to the reporting date; and
- reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The amount of ECLs recognised as a loss allowance depends on the extent of credit deterioration since initial recognition. There are two measurement bases:

- 12-month ECLs (Stage 1), which applies to all items as long as there is no significant deterioration in credit quality since initial recognition; and
- Lifetime ECLs (Stages 2 and 3), which applies when a significant increase in credit risk has occurred on an individual or collective basis.

The 12 month ECL is the portion of lifetime expected credit losses that represent the expected credit losses that result from default events on a financial instrument that are possible within the 12 months after the reporting date. Lifetime ECL is the expected credit losses that result from all possible default events over the expected life of a financial instrument.

In the case of Stage 2, credit risk on the financial instrument has increased significantly since initial recognition but the instrument is not considered credit impaired. For a financial instrument in Stage 3, credit risk has increased significantly since initial recognition and the instrument is considered credit impaired.

Financial assets are allocated to stages dependent on credit quality relative to when the asset was originated.

A financial asset can only originate in either Stage 1 or as purchased or originated credit impaired (“POCI”). The ECL held against an asset depends on a number of factors, one of which is its stage allocation. Assets allocated to Stage 2 and Stage 3 have lifetime ECLs.

Collateral and other credit enhancements are not considered as part of stage allocation. Collateral is reflected in the Bank’s loss given default models (‘LGD’).

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.9. Impairment of financial assets (continued)
Purchased or originated credit impaired

Purchased or originated credit impaired ("POCI") financial assets are those that are credit-impaired on initial recognition. The Bank may originate a credit-impaired financial asset following a substantial modification of a distressed financial asset that resulted in derecognition of the original financial asset.

POCIs are assets originated credit impaired where the difference between the discounted contractual cash flows and the fair value at origination is greater than or equal to 5%. The Bank uses an appropriate discount rate for measuring ECL in the case of POCIs which is the credit-adjusted EIR. This rate is used to discount the expected cash flows of such assets to fair value on initial recognition.

POCIs remain outside of the normal stage allocation process for the lifetime of the obligation. The ECL for POCIs is always measured at an amount equal to lifetime expected credit losses. The amount recognised as a loss allowance for these assets is the cumulative changes in lifetime expected credit losses since the initial recognition of the assets rather than the total amount of lifetime expected credit losses.

At each reporting date, the Bank recognises the amount of the change in lifetime expected credit losses as a credit impairment gain or loss in profit or loss. Favourable changes in lifetime expected credit losses are recognised as a credit impairment gain, even if the favourable changes exceed the amount previously recognised in profit or loss as a credit impairment loss.

Modification

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

A modification refers to either:

- A change to the previous terms and conditions of a debt contract; or
- A total or partial refinancing of a debt contract.

Modifications may occur for both customers in distress and for those not in distress. Any financial asset that undergoes a change or renegotiation of cash flows and is not derecognised is a modified financial asset.

When modification does not result in derecognition, the modified assets are treated as the same continuous lending agreement but requires a modification gain or loss to be taken to profit or loss immediately. The gross carrying amount of the financial asset is recalculated as the present value of the renegotiated or modified contractual cash flows discounted at the financial asset's original effective interest rate. Any costs or fees incurred adjust the carrying amount of the modified financial asset and are amortised over the remaining term of the modified financial asset.

The stage allocation for modified assets which are not derecognised is by reference to the credit risk at initial recognition of the original, unmodified contractual terms i.e. the date of initial recognition is not reset.

Where renegotiation of the terms of a financial asset 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.

Derecognition occurs if a modification or restructure is substantial on a qualitative or quantitative basis. Accordingly, certain forborne assets are derecognised. The modified/restructured asset (derecognised forborne asset ('DFA')) is considered a 'new financial instrument' and the date that the new asset is recognised is the date of initial recognition from this point forward. DFAs are allocated to Stage 1 on origination and follow the normal staging process, thereafter.

If there is evidence of credit impairment at the time of initial recognition of a DFA, and the fair value at recognition is at a discount to the contractual amount of the obligation, the asset is deemed to be a POCI. POCIs are not allocated to stages but are assigned a lifetime PD and ECL for the duration of the obligation's life. Where the modification/restructure of a non-forborne credit obligation results in derecognition, the new loan is originated in Stage 1 and follows the normal staging process thereafter.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.9. Impairment of financial assets (continued)

Collateralised financial assets – Repossessions

The ECL calculation for 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 credit 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 that asset and not as a credit impairment of the original loan.

Financial assets at FVOCI

ECL allowances for financial assets measured at FVOCI do not reduce the carrying amount in the statement of financial position because the carrying amount of these assets is fair value. However, an amount equal to the ECL allowance that would arise if the assets were measured at amortised cost is recognised in other comprehensive income ('OCI') as an accumulated credit impairment amount, with a corresponding charge to profit or loss. The accumulated loss recognised in OCI is recycled to the profit or loss upon derecognition of the assets (together with other accumulated gains and losses in OCI).

Write-offs and debt forgiveness

The Bank reduces the gross carrying amount of a financial asset either partially or fully when there is no reasonable expectation of recovery.

Where there is no formal debt forgiveness agreed with the customer, the Bank may write off a loan either partially or fully when there is no reasonable expectation of recovery. This is considered a non-contracted write-off. In this case, the borrower remains fully liable for the credit obligation and is not advised of the write-off.

Debt forgiveness arises where there is a formal contract agreed with the customer for the write-off of a loan.

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.

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

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

1.13. Shareholder's Equity
Issued financial instruments, or their components, are classified as equity where they meet the definition of equity and confer on the holder a residual interest in the assets of the Bank. Incremental costs directly attributable to the issue of an equity instrument are deducted from the initial measurement of the equity instrument. 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
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 IFRS 9 continue to be measured in accordance with that standard.

Notes to the Financial Statements (continued)

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. Exchange differences on equities and similar non-monetary items held at fair value through profit or loss are reported as part of the fair value gain or loss. Exchange differences on equities designated at FVOCI, together with exchange differences on a financial liability designated as a hedge of the net investment in a foreign operation are reported in other comprehensive income.

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:

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.

IFRIC 23 is not expected to have a material insignificant effect on the financial statements.

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

Notes to the Financial Statements (continued)

1. ACCOUNTING POLICIES (continued)

1.17. Prospective accounting changes (continued)
Amendments to IAS 1 and IAS 8: Definition of Material
The amendments to IAS 1 and IAS 8 regarding the definition of material which were issued in October 2018, clarify the definition of material through the following changes:

- A revised definition of 'material' which is included in the defined terms
- as follows "Information is material if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the primary users of general purpose financial statements make on the basis of those financial statements, which provide financial information about a specific reporting entity".

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

Effective date: Annual reporting periods beginning on or after 1 January 2020.

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.

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) Impairment of financial assets

The Bank's accounting policy for impairment of financial assets is set out in accounting policy 1.9 in note 1. The expected credit loss ('ECL') allowances for financial assets at 31 December 2018 represent management's best estimate of the expected credit losses on the various portfolios at the reporting date.

On 1 January 2018, the Bank implemented the three stage ECL impairment model under IFRS 9. The calculation of ECL allowances is required for all financial assets measured at amortised cost, financial assets at FVOCI (apart from equities) and loan commitments and financial guarantee contracts. The estimation of ECL allowances is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local and international economic climates both current and evolving, conditions in various industries to which the Group is exposed and other external factors such as legal and regulatory requirements.

The implementation of an expected credit loss model for the first time has resulted in a new methodology and basis for calculating impairment losses compared to the incurred loss model under IAS 39. The calculation of ECL allowances is complex and therefore, an entity must consider much more information in the determination of such expectations of future credit losses. This process requires significant use of estimates, judgements and assumptions, some of which, by their nature, are highly subjective and very sensitive to risk factors such as changes to economic conditions. Further information on the IFRS 9 methodologies and judgements is detailed on pages 19 to 26.

The management process for the calculation of ECL allowances is underpinned by independent tiers of review. Credit quality and ECL provisioning are independently monitored by credit and risk management on a regular basis. All the Group's segments assess and approve their ECL allowances and their adequacy on a quarterly basis. These ECL allowances are, in turn, reviewed and approved by the Group Credit Committee on a quarterly basis with final Group levels being approved by the Board Audit Committee. Further detail on the ECL governance process is set out on page 19.

On an on-going basis, the various judgements, estimates and assumptions are reviewed in light of differences between actual and previously calculated expected losses. These are then recalibrated and refined to reflect current and evolving economic conditions

After a period of time, when it is concluded that there is no reasonable expectation of recovering a Stage 3 loan in its entirety or a portion thereof, the Bank reduces the gross carrying amount directly by the relevant ECL allowance for that amount deemed irrecoverable.

Inputs for calculating ECL allowances

The inputs to models used to derive ECL allowances rely, to a large extent, on reasonably supportable past events as predictors of future outcomes. Given the severe financial crisis which affected the Irish banking sector in the past, the use of historical loss data as a predictor of future outcomes may not relevant due to significant changes in circumstances albeit that this data has been be adjusted on the basis of current observable data in order to reflect the effects of current conditions.
The ECL methodology has resulted in a reassessment of the critical accounting judgements and estimates used for the determination of loss allowances which are as follows:

– Determining the criteria for a significant increase in credit risk and for being classified as credit impaired;
– Choosing the appropriate models and assumptions for measuring ECL, e.g. PD, LGD and EAD;
– Determining the life of a financial instrument and therefore, the period over which to measure ECL;
– Establishing the number and relative weightings for forward looking scenarios for each asset class and ECL, particularly in relation to Brexit;
– Stratifying financial assets into groups with similar risk characteristics.

Notes to the Financial Statements (continued)

2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

Inputs for calculating ECL allowances (continued)
The Bank estimates its ECL provisions on Mortgages based on its historic experience of working out arrangements with customers which predominantly consist of split mortgages, low fixed interest rate, voluntary sale for loss, negative equity trade down and positive equity solutions. This is consistent with the Bank's strategy to deliver sustainable long-term solutions and to support customers. In particular, the IFRS 9 Mortgage LGD model which was implemented from 1 January 2018 is based on the actual empirical internal data for such resolved and unresolved cases, and represents the Bank's expected loss based on those current and expected work-out strategies at the time. However, for a cohort of loans that are deep in arrears and/or in a legal process for a significant period of time, it is recognised that alternative recovery strategies may need to be considered. To reflect the range of possible outcomes for this cohort where alternative recovery strategies are required, management judgement has been applied to increase the ECL outcome on transition on 1 January 2018 and as at 31 December 2018.

Forbearance
The Bank's accounting policy for forbearance is set out in accounting policy 1.9 'Impairment of financial assets' in note 1 which incorporates forbearance. The Bank has developed a number of forbearance strategies for both short-term and longer-term solutions to assist customers experiencing financial difficulties. The forbearance strategies involve modifications to contractual repayment terms in order to improve the collectability of outstanding debt, to avoid default, and where relevant, to avoid repossessions. Forbearance strategies take place in both retail and business portfolios, particularly, residential mortgages. Where levels of forbearance are significant, higher levels of uncertainty with regard to judgement and estimation are involved in determining the effects of forbearance strategies on ECL allowances and on the future cash flows arising from restructured loans. Further information on forbearance strategies is set out in the 'Risk management' section of this report.
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.

(b) 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.

(c) Provisions for liabilities and commitments
The Bank's accounting policy for provisions for liabilities and commitments is set out in accounting policy 1.10. 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 19 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.

In March 2018, EBS was advised by the CBI of the commencement of investigations as part of an administrative sanctions procedure in connection with the Tracker Mortgage Examination. The investigations relate to alleged breaches of the relevant consumer protection legislation, principally regarding inadequate controls or instances where EBS acted with a lack of transparency, unfairly or without due skill and care. The investigations are ongoing and EBS are co-operating with the CBI in this regard.

In addition, litigation has been served on the Group by customers that are pursuing claims in relation to tracker mortgages. Further cases may be served in the future in relation to tracker mortgages.

Based on the facts currently known and the current stages that the investigations and litigation are at, it is not practical at this time to predict the final outcome of these investigations and litigation, nor the timing and possible impact, including any monetary penalties on EBS. Accordingly, EBS has not made any provision at this stage in relation to these matters.

Notes to the Financial Statements (continued)

3. TRANSITION TO IFRS 9

(a) Summary
On 1 January 2018, the Bank implemented the requirements of IFRS 9 *Financial Instruments*, a new accounting standard, replacing IAS 39 *Financial Instruments: Recognition and Measurement*. In addition, the Bank early adopted a narrow scope amendment to IFRS 9 titled *'Prepayment features with Negative Compensation'* which was endorsed by the European Union in March 2018.

As permitted by IFRS 9, the Bank did not restate prior periods on initial application, accordingly, any difference arising between IAS 39 carrying amounts and IFRS 9 carrying amounts at 1 January 2018 are recognised in opening retained earnings (or in other comprehensive income, as applicable) at 1 January 2018.

The information set out in this note provides details relevant to understanding the impact of IFRS 9 on the Bank's financial position at 1 January 2018 and has been prepared in accordance with the requirements for initial application of IFRS 9 as set out in IFRS 7 *Financial Instruments: Disclosures.* The disclosures supplement those provided in the Annual Financial Report 2017 and precede those required in the Annual Financial Report 2018. These transition disclosures provide a point-in-time bridge between IAS 39 *Financial Instruments: Recognition and Measurement,* IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IFRS 9 *Financial Instruments* results and should be read in conjunction with the IFRS 9 related accounting policies set out on pages 61 to 69 and the credit impairment methodologies and judgements set out on pages 19 to 26.

IFRS 9 impacts the accounting for financial instruments in the following areas:
Classification and measurement – the classification of financial assets under IFRS 9 determines how they are accounted for and how they are measured on an on-going basis. This did not result in any significant changes for the Bank at initial recognition.

Impairment – IFRS 9 introduces an expected credit loss model that requires recognition of expected credit losses on all financial assets measured at amortised cost or at FVOCI. This resulted in an overall reduction in loss allowances of €45m for the Bank.

Hedge accounting – IFRS 9 introduces an approach that aligns hedge accounting more closely with risk management. This had no impact for the Bank as it is exercising a policy choice, as permitted by IFRS 9, to continue hedge accounting under IAS 39. However, the Bank will implement the revised hedge accounting disclosures required by the amendments to IFRS 7.

The opening statement of financial position at 1 January 2018 under IFRS 9 is set out on page 78. This shows an increase in net assets of €45m with a corresponding increase in shareholders' equity driven by credit impairment provisions on loans and advances amounting to €39m, net of related deferred tax amounting to €6m and an increase in deferred tax liability of €6m.

In particular, the following table reconciles impairment provisions (specific and IBNR) under IAS 39 and provisions for loan commitments and financial guarantee contracts under IAS 37 at 31 December 2017 to the opening loss allowance determined in accordance with IFRS 9 at 1 January 2018.

	31 December 2017			1 January 2018
	Impairment allowance under IAS 39 or provision under IAS 37	Reclassification Impact	Additional IFRS 9 loss allowance	Loss allowance under IFRS 9
Impairment Allowance	**€ m**	**€ m**	**€ m**	**€ m**
Loans and advances to customers at amortised cost	**290**	**-**	**(45)**	**245**
Loans and advances to banks at amortised cost	**-**	**-**	**-**	**-**
Undrawn commitments	**-**	**-**	**-**	**-**
Total	**290**	**-**	**(45)**	**245**

Notes to the Financial Statements (continued)

3. TRANSITION TO IFRS 9 (continued)

IFRS 9 impacts the accounting for financial instruments in the following areas: (continued)

The following table presents a reconciliation of gross loans and advances to customers at amortised cost together with impairment provisions under IAS 39 to gross loans and advances to customers at amortised cost together with loss allowances, analysed by staging under IFRS 9.

	At 31 December 2017	IFRS 9 transition adjustments		At 1 January 2018
	IAS 39	Reclassified	Remeasured	Total
Impairment Allowance	**€ m**	**€ m**	**€ m**	**€ m**
Gross loans and advances to customers	4,740	-	-	4,740
Impairment provisions/loss allowance	(290)	-	45	(245)
Carrying amount	**4,450**	**-**	**45**	**4,495**

					At 1 January 2018 IFRS 9
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	€ m	**€ m**	**€ m**	**€ m**	**€ m**
Gross loans and advances to customers	3,242	750	674	74	4,740
Impairment provisions/loss allowance	(2)	(20)	(219)	(4)	(245)
Carrying amount	**3,240**	**730**	**455**	**70**	**4,495**
	%	%	%	%	%
Loss allowance coverage rate	**0.06%**	**2.67%**	**32.49%**	**5.41%**	**5.17%**

(b) Principal impacts of IFRS 9

This section details the principal impacts of IFRS 9 in relation to classification and measurement, impairment and hedge accounting.

(i) Classification and measurement

The classification of financial assets under IFRS 9 determines how they are accounted for, and, in particular, how they are measured on an on-going basis.

- 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 ("FVOCI") and fair value through profit or loss ("FVTPL");
- 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 loss allowance;
- There is no separation of an embedded derivative where the instrument is a financial asset;
- 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.

3. TRANSITION TO IFRS 9 (continued)

(i) Classification and measurement (continued)
Classification and measurement of financial assets did not result in any significant changes for the Bank. In general:
- loans and advances to banks and customers that were classified as 'loans and receivables' under IAS 39 are measured at amortised cost under IFRS 9;
- debt securities classified as available for sale under IAS 39 are measured at FVOCI.

The business model assessment which was carried out did not result in any change to the current measurement basis at the Bank level.

In relation to SPPI testing which was carried out on the financial instruments portfolio, a small number of loans and advances to customers failed the SPPI test. Accordingly, such instruments are measured at FVTPL in accordance with IFRS 9. Fair value movements on these instruments will be shown in profit or loss. There was no impact on the carrying value on transition to this new measurement basis.

The Bank has not currently opted to designate any financial assets at FVTPL 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.

The Bank has set up governance structures for the on-going validation of its business models and for ensuring that financial instruments failing the SPPI test are correctly identified at initial recognition.

(ii) Impairment
IFRS 9 introduces a new impairment model that requires the recognition of expected credit losses on all financial assets measured at amortised cost or at FVOCI. Expected credit losses on certain loan commitments and on financial guarantee contracts together with lease receivables are also covered by this new impairment model. Under IAS 39, impairment losses were compiled on an 'incurred loss' basis where there was objective evidence of impairment. In particular, IFRS 9:
- Requires more timely recognition of expected credit losses using a three stage approach. For financial assets where there has been no significant increase in credit risk since origination, an allowance 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, an allowance for 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 losses;
- The assessment of credit risk, and the estimation of expected credit losses, are required to be unbiased and probability-weighted. They 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 losses should take into account the time value of money. As a result, the recognition and measurement of impairment is now more forward-looking unlike IAS 39 and the resulting credit impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of credit loss allowances, since all financial assets will be assessed for at least 12 month expected credit losses and the population of financial assets to which lifetime expected credit losses apply is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

The impact of IFRS 9 on credit loss allowances is set out below. The credit impairment methodologies and judgements applied are set out in the 'Risk management' section of this report on pages 11 to 46.

(iii) Hedge accounting
IFRS 9 introduces an approach that aligns hedge accounting more closely with risk management. It makes some fundamental changes to the requirements under IAS 39 by removing or amending some of the key prohibitions and rules. However, many of these changes are more relevant to non-financial corporations.

The general hedge accounting requirements of IFRS 9 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 until macro hedge accounting is addressed by the IASB as part of a separate project.

Notes to the Financial Statements (continued)

3. TRANSITION TO IFRS 9 (continued)

(iii) Hedge accounting (continued)
The Bank is exercising this policy choice and will continue to account under IAS 39. However, it has implemented the revised hedge accounting disclosures required by the amendments to IFRS 7.

(c) Financial statement impacts at 1 January 2018
This section sets out: the opening statement of financial position; the impact of classification and measurement on the Bank's financial assets; an impairment reconciliation; and revenue reserves and other components of equity reconciliations at 1 January 2018.

(i) Opening statement of financial position
The following table reconciles the statement of financial position under IAS 39 at 31 December 2017 to that under IFRS 9 at 1 January 2018.

	31 December 2017 (IAS 39) € m	Classification and Measurement € m	Loss Allowance € m	Tax € m	1 January 2018 (IFRS 9) € m
Assets					
Disposal groups and non-current assets held for sale	1	-	-	-	1
Derivative financial instruments	20	-	-	-	20
Loans and advances to banks	69	-		-	69
Loans and advances to customers	4,450	-	45	-	4,495
Prepayments and accrued income	1	-	-	-	1
Total assets	4,541	-	45	-	4,586
Liabilities					
Deposits by central banks and	1,723	-	-	-	1,723
Derivative financial instruments	20	-	-	-	20
Debt securities in issue	2,022	-	-	-	2,022
Deferred tax liabilities	-	-	-	6	6
Other liabilities	2	-	-	-	2
Provisions for liabilities and commitments	1	-	-	-	1
Total liabilities	3,768	-	-	6	3,774
Equity					
Share capital	552	-	-	-	552
Revenue reserves	221	-	45	(6)	260
Total shareholders' equity	773	-	45	(6)	812
Total liabilities and equity	4,541	-	45	-	4,586

Notes to the Financial Statements (continued)

3. TRANSITION TO IFRS 9 (continued)

(ii) Financial assets - Classification and measurement

The following table summarises the impact of classification and measurement on the Bank's financial assets at 1 January 2018.

Financial assets	Original measurement category determined in accordance with IAS 39 at 31 December 2017	New measurement category determined in accordance with IFRS 9 at 1 January 2018	Carrying amount determined in accordance with IAS 39 at 31 December 2017	Carrying amount determined in accordance with IFRS 9 at 1 January 2018
			€ m	€ m
Derivative financial instruments	Fair value	FVTPL (mandatory)	20	20
Loans and advances to banks	Loans and advances	Amortised cost	69	69
Loans and advances to customers	Loans and advances	Amortised cost	4,450	4,495
Total assets			**4,539**	**4,584**

There were no changes in the classification of financial liabilities.

(iii) Impairment reconciliation

The following table reconciles the closing impairment provision (recognised in accordance with IAS 39) and any provision for loan commitments and financial guarantee contracts (recognised in accordance with IAS 37) as at 31 December 2017 to the opening ECL allowances (in accordance with IFRS 9) as at 1 January 2018:

Financial assets at amortised cost	Provision at at 31 December 2017 (IAS 39)	Reclassification	Remeasurement	1 January 2018 (IFRS 9)
	€ m	€ m	€ m	€ m
Loans and advances to customers	290	-	(45)	245
	290	-	(45)	245

Recognised in statement of financial position as:	At 31 December 2017	Reclassification	Remeasurement	At 1 January 2018
	€ m	€ m	€ m	€ m
Impairment provision/ECL allowance - IAS39/IFRS9	290	-	(45)	245
Provision for liabilities and commitments - IAS37/IFRS9	-	-	-	-
	290	-	(45)	245

Notes to the Financial Statements (continued)

3. TRANSITION TO IFRS 9 (continued)

(iv) Revenue reserves and other components of equity reconciliations
The following table sets out the impact of applying IFRS 9 on opening revenue reserves and other components of equity as at 1 January 2018:

Revenue Reserves	Gross € m	Taxation € m	Net € m
Closing balance at 31 December 2017 (IAS39)			221
Recognition of expected credit losses for loans and advances to customers at amortised cost	45	(6)	39
	45	(6)	39
Opening balance at 1 January 2018 (IFRS9)	-	-	260
IFRS9 transition adjustment to total reserves at 1 January 2018	45	(6)	39

(d) Analysis of financial instruments by staging
This section provides detailed analysis of: exposures within the scope of the ECL framework by balance sheet caption and staging; loans and advances to customers by asset class and staging; off-balance sheet commitments by staging; loans and advances to customers by segment and staging; and forbearance by staging.

(i) Exposures within the scope of the ECL framework by balance sheet caption and staging
The following table analyses exposures within the scope of IFRS 9 including off-balance sheet commitments and guarantees. Exposures are shown gross of ECL.

Items outside the scope of the ECL framework such as cash and items in the course of collection are excluded from this table as it is the Bank policy not to calculate an ECL for such items as they have a low risk of default with a very low risk profile. In addition, equity investments have been excluded as they are outside the scope of the ECL framework.

					1 January 2018
	Stage 1 € m	Stage 2 € m	Stage 3 € m	POCI € m	Total € m
Loans and advances to banks	69	-	-	-	69
Loans and advances to customers	3,242	750	674	74	4,740
Total assets	3,311	750	674	74	4,809
Undrawn commitments	12	-	-	-	12
Total exposure	3,323	750	674	74	4,821

Notes to the Financial Statements (continued)

4. INTEREST INCOME

	2018	2017
	€ m	€ m
Interest on loans and advances to customers	129	147
Amortisation of fair value discount on loans and advances to customers	-	33
Interest received from Group undertaking	4	-
	133	180

All interest income is calculated using the effective interest method.

In 2017, interest income recognised on impaired loans amounted to €12m.

5. INTEREST EXPENSE

	2018	2017
	€ m	€ m
Interest payable to credit institutions	7	13
Interest on debt securities in issue	7	2
Amortisation of fair value discount on debt securities in issue	(3)	-
	11	15

6. NET TRADING INCOME

	2018	2017
	€ m	€ m
Debt Securities and interest rate contracts	2	2
	2	2

There was no net trading gain (2017: €1m) to reflect a movement in the mark to market valuation of swap hedging instruments.

7. NET GAIN ON OTHER FINANCIAL ASSETS MEASURED AT FVTPL

	2018	2017
	€ m	€ m
Loans and advances to customers	1	-
	1	-

Gains and losses on derecognition have been computed at a customer connection level

8. OTHER OPERATING INCOME

	2018 € m	2017 € m
Miscellaneous operating income	**-**	1
	-	1

9. ADMINISTRATIVE EXPENSES

	2018 € m	2017 € m
Other administrative expenses	**14**	(6)
Amounts payable to EBS	**57**	104
	71	98

In 2017, a review was completed of pricing arrangements between AIB and the Bank. Arising from this review, a new pricing agreement was 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 decreased to €57m in 2018m from €104m in 2017 following the revision of the transfer pricing calculation for 2018. This service charge is offset by higher provisions for the Tracker Mortgage Examination, lower interest income as the loan book declines and a decrease in ECL writebacks.

Other administrative expenses consists of statutory payments (regulatory payments/levies) €3.8m (2017: €3.2m), professional fees €0.4m (2017: €0.5m) and charge in relation to provisions for liabilities & commitments €10.1m which related to customer redress and other costs (2017: €9.7m). See also note 19 provisions for liabilities and commitments.

There were no full time equivalents employed by the Bank in the financial year 2018 (2017: 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)

	2018 € '000	2017 € '000
Statutory Audit of entity financial statements	**13**	13
Other assurance services	**-**	-
Tax advisory services	**-**	-
Other non-audit services	**-**	-
Total auditors' remuneration	**13**	13

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

Notes to the Financial Statements (continued)

9. ADMINISTRATIVE EXPENSES (continued)

The remuneration of the Non-Executive Directors in office during 2018 is as follows:

	2018	2017
	€ '000	€ '000
Fees	**35**	32
	35	32

	2018	2017
	€'000	€'000
Denis Holland	**11**	15
William Cunningham	**4**	15
Brendan McDonagh	**10**	1
Jim O'Hara	**10**	1

Additional remuneration has not been paid 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 (2017: Nil) to persons connected with a director in accordance with Section 306(1) of the Companies Act 2014.

10. NET CREDIT IMPAIRMENT WRITEBACK/ (LOSSES)

Credit impairment writeback /(losses) on financial instruments	**2018 Total Measured at amortised cost € m**
Net measurement of loss allowance	
Loans and advances to customers	**(13)**
Credit impairment writeback/(losses)	**(13)**
Recoveries of amounts previously written off	**4**
Net credit impairment writeback/(losses)	**(9)**

	2017
	€ m
Charge of provisions for impairment on loans and advances	(40)

Notes to the Financial Statements (continued)

11. TAXATION

	2018 € m	2017 € m
Current tax charge on income for financial year	**(6)**	(4)
Total tax charge for the financial year	**(6)**	(4)

The tax charge (2017: charge) for the financial year is at an effective rate of 12.5%, which is the same as the standard Irish corporation tax rate.

	2018		2017	
	€ m	%	€ m	%
Operating profit before taxation	**45**		30	
Corporation tax charge (12.5%)	**(6)**	**12.5**	(4)	12.5
Tax charge	**(6)**	**12.5**	(4)	12.5

12. NON-CURRENT ASSETS HELD FOR SALE

The number (stock) of properties in possession at 31 December 2018 and 2017 is set out below:

	2018 € m	2017 € m
Repossessed assets	**2**	1
	2	1

The Bank seeks to avoid repossession through working with customers, but where agreement cannot be reached, it 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.

13. 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.

	2018			2017		
	Contract/ Notional Amount € m	Fair Value Asset € m	Fair Value Liability € m	Contract/ Notional Amount € m	Fair Value Asset € m	Fair Value Liability € m
Derivatives classified as trading						
Interest rate swaps	**4,404**	**23**	**23**	4,834	20	20
Total derivatives	**4,404**	**23**	**23**	4,834	20	20

Notes to the Financial Statements (continued)

13. DERIVATIVE FINANCIAL INSTRUMENTS (continued)

The following table represents the underlying principal and gross replacement costs of the Bank's derivatives as at 31 December 2018 and 31 December 2017.

	Residual Maturity 2018				Residual Maturity 2017			
	Within 1yr	**1 to 5 yrs**	**Over 5 yrs**	**Total**	Within 1 yr	1 to 5 yrs	Over 5 yrs	Total
	€ m	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m	€ m
Underlying principal amount								
Interest rate Contracts	**-**	**-**	**4,404**	**4,404**	-	-	4,834	4,834
Positive fair value								
Interest rate contracts	**-**	**-**	**23**	**23**	-	-	20	20

14. LOANS AND ADVANCES TO BANKS

	2018	2017
	€ m	€ m
Funds placed with EBS		
Analysed by remaining maturity:		
3 months or less	**58**	56
Funds placed with other banks outside AIB		
Analysed by remaining maturity:		
3 months or less	**17**	13
	75	69

For the purpose of cash flows the cash and cash equivalents comprise the above. Loans and advances 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 2018, the Bank's credit rating with Moody's was Aaa. At 31 December 2018, BNP bank credit rating with Standard & Poor's was A, KBC bank credit rating was A.

15. LOANS AND ADVANCES TO CUSTOMERS

	2018	2017[(1)]
	€ m	€ m
Analysed by remaining maturity:		
Repayable on demand	**293**	590
3 months or less	**-**	-
1 year or less but over 3 months	**3**	2
5 years or less but over 1 year	**87**	85
Greater than 5 years	**3,794**	4,063
	4,177	4,740
Expected Credit Loss Allowance	**(129)**	(290)
	4,048	4,450

[(1)]Comparative data for 31 December 2017 has been prepared under IAS 39.

15. LOANS AND ADVANCES TO CUSTOMERS (continued)

Loss allowance on financial assets

The following table shows the movements on the impairment loss allowance on financial assets. Comparative data for 31 December 2017 has been prepared under IAS 39.

	IFRS 9 31 December 2018 € m
Opening balance	**290**
Transition to IFRS 9	**(45)**
Net remeasurement of loss allowance	**13**
Changes in loss allowance due to write-offs	**(129)**
At 31 December 2018	**129**
Amounts include loss allowance on:	
Loans and advances to customers measured at amortised cost	**129**

For details of the impact of adopting IFRS 9 at 1 January 2018, see note 3.

			2017[1]
	Specific € m	IBNR € m	Total € m
Balance at start of year	258	29	287
Charge against income statement	22	18	40
Amounts written off	(37)	-	(37)
Balance at end of year	243	47	290

[1]Comparative data for 31 December 2017 has been prepared under IAS 39.

Loans and advances 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 their lending conditions.

By geographic location and industry sector	**2018 € m**	2017 € m
Republic of Ireland		
Home mortgages (Expected credit loss allowance)	**4,048**	4,450
	4,048	4,450

16. DEFERRED TAXATION

	2018 € m	2017 € m
Deferred tax assets:		
Unutilised tax losses	**-**	-
Other	**-**	-
Total gross deferred tax assets	**-**	-
Deferred tax liabilities:		
Total gross deferred tax liabilities	**(4)**	-
Net deferred tax liabilities	**(4)**	-

Notes to the Financial Statements (continued)

16. DEFERRED TAXATION (continued)

Analysis of movements in deferred taxation	**2018**	2017
	€ m	€ m
Opening balance	**-**	-
Transition to IFRS 9	**(6)**	
At 1 January	**(6)**	-
Other adjustments	**2**	-
Income statement	**-**	-
At 31 December	**(4)**	-

At 31 December 2018 deferred tax assets on unutilised tax losses totalled Nil (2017: Nil). Deferred tax liability is expected to be utilised within 4 years.

17. DEPOSITS BY BANKS

	2018	2017
	€ m	€ m
Funds received from EBS	**729**	1,723
	729	1,723

The facility limit with EBS is €4.0bn and the balance at 31 December 2018 amounted to €729m (2017: €1.7bn). 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.

18. DEBT SECURITIES IN ISSUE

	2018	2017
	€ m	€ 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	**1,500**	1,000
Greater than 5 years	**1,038**	1,022
Carrying value of Debt Securities	**2,538**	2,022
Mortgage covered securities to internal issuances at nominal value:		
EBS	**2,538**	2,022
	2,538	2,022

18. DEBT SECURITIES IN ISSUE (continued)

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 2018, the Cover Assets Pool amounted to €3.38bn (2017: €3.78bn), comprising of €3.36bn (2017: €3.77bn) of mortgage credit assets (mortgage loan accounts) and €0.02bn (2017: €0.01bn) 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

		Total Loan Balances	**Number of Mortgaged Properties**	Total Loan Balances	Number of Mortgaged Properties
		2018 **(1 & 2)**	**2018**	2017 (1 & 2)	2017
From	To	**€ m**		€ m	
€0	€100,000	**478**	**10,013**	503	10,640
€100,000	€200,000	**1,508**	**10,144**	1,604	10,756
€200,000	€500,000	**1,309**	**5,119**	1,581	6,133
Over €500,000		**61**	**94**	79	118
		3,356	**25,370**	3,767	27,647

(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 31,799 loan accounts (2017: 34,998) secured on 25,370 properties (2017: 27,647).

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

Geographical Area	**Number of Mortgaged Properties**		Number of Mortgaged Properties	
	2018		2017	
Co. Dublin	**8,983**	**35%**	9,886	36%
Outside Co. Dublin	**16,387**	**65%**	17,761	64%
	25,370	**100%**	27,647	100%

(c) Mortgage loan accounts in default in the Cover Assets Pool with arrears greater than or equal to three months
As at 31 December 2018, there were 77 mortgage loan accounts (2017: 75) 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 2018, 1,151 mortgage loan accounts (2017: 1,121) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2018, there were 277 accounts in default in the Cover Assets Pool (2017: 347).

(e) Replacement of non-performing mortgage loan accounts from the Cover Assets Pool
During the year ended 31 December 2018, 147 non-performing mortgage loan accounts (2017: 108) 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.

18. DEBT SECURITIES IN ISSUE (continued)

(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 724 accounts (2017: 942) as at 31 December 2018 was €0.40m (2017: €0.48m).

(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 2018 was €479m (2017: €468m), of which €375m (2017: €353m) represented repayment of principal and €104m (2017: €115m) 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 2018 there were no loan accounts (2017: Nil) in the Cover Assets Pool that were secured on commercial properties.

19. PROVISIONS FOR LIABILITIES AND COMMITMENTS

	2018 **€ m**	2017 € m
Opening balance	**1**	14
Amounts charged to income statement	**10**	-
Amounts written back to income statement	**-**	(10)
Provisions utilised	**(11)**	(3)
At 31 December [1]	**-**	1

[1] The total provisions for liabilities and commitments expected to be settled within one year amount to Nil (2017: €1m).

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 three years €16m was written back to the income statement, and €5m was utilised for customer redress. In 2018 an additional €10m was charged to income statement in 2018 which was fully utilised within the year, bringing the provision for customer redress and compensation to Nil at 31 December 2018.

In 2015, the Bank also created a provision of €14m with regard to 'Other costs'. Over the past three years €9m was written back to the income statement and the remaining €5m was fully utilised bringing the provision for 'Other costs' to Nil at 31 December 2018.

In March 2018, EBS were advised by the CBI of the commencement of investigations as part of an administrative sanctions procedure in connection with the Tracker Mortgage Examination. The investigations relate to alleged breaches of the relevant consumer protection legislation, principally regarding inadequate controls or instances where EBS acted with a lack of transparency, unfairly or without due skill and care. The investigations are ongoing and EBS are co-operating with the CBI in this regard.

In addition, litigation has been served on the Group by customers that are pursuing claims in relation to tracker mortgages. Further cases may be served in the future in relation to tracker mortgages.

Based on the facts currently known and the current stages that the investigations and litigation are at, it is not practical at this time to predict the final outcome of these investigations and litigation, nor the timing and possible impact, including any monetary penalties on the Group. Accordingly, the Bank and EBS have not made any provision at this stage in relation to these matters.

20. ISSUED SHARE CAPITAL PRESENTED AS EQUITY

	2018 € m	2017 € m
Authorised:		
1,000,000,000 ordinary shares of €1.00 each	**1,000**	1,000
(2017: 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
(2017: 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.

21. 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
- harmonising 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 until 2018. The only remaining transitional arrangement for EBS MF relates to mitigating the impact of the introduction of IFRS 9 on capital as per Regulation (EU) 2017/2395 of the European Parliament which currently has no impact on EBS MF.

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.

22. STATEMENT OF CASH FLOWS

Analysis of Cash and Cash Equivalents

	2018 € m	2017 € m
Loans and advances to banks (note 14)	**75**	69
	75	69

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

23. SEGMENTAL INFORMATION

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

24. 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.

Notes to the Financial Statements (continued)

24. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)
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 2018.

The valuation of financial instruments, including loans and advances, involves the application of judgement and estimation. Market and credit risks are key assumptions in the estimation of the fair value of loans and advances. 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.

Financial instruments not measured at fair value but with fair value information presented separately in the notes to the financial statements.

Loans and advances to banks
The fair value of loans and advances 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 advances 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 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 2018 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

24. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

2018

	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 advances	Other	
Financial assets measured at fair value	€ m	€ m	€ m	€ m	€ m
Interest rate derivatives	23	-	-	-	23
Financial assets not measured at fair value					
Loans and advances to banks	-	-	75	-	75
Loans and advances to customers	-	-	4,048	-	4,048
	23	-	4,123	-	4,146
Financial liabilities measured at fair value					
Interest rate derivatives	23	-	-	-	23
Financial liabilities not measured at fair value					
Deposits by banks	-	-	-	729	729
Debt securities in issue	-	-	-	2,538	2,538
Other financial assets	-	-	-	3	3
	23	-	-	3,270	3,293

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 advances	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 advances to banks	-	-	69	-	69
Loans and advances 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

Notes to the Financial Statements (continued)

24. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

2018

	Fair value hierarchy			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial assets measured at fair value	**€ m**	**€ m**	**€ m**	**€ m**
Interest rate derivatives	**-**	**23**	**-**	**23**
Financial assets not measured at fair value				
Loans and advances to banks	**-**	**-**	**75**	**75**
Loans and advances to customers	**-**	**-**	**4,065**	**4,065**
	-	**23**	**4,140**	**4,163**
Financial liabilities measured at fair value				
Interest rate derivatives	**-**	**23**	**-**	**23**
Financial liabilities not measured at fair value				
Deposits by banks	**-**	**-**	**729**	**729**
Debt securities in issue	**-**	**1,975**	**-**	**1,975**
	-	**1,998**	**729**	**2,727**

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 advances to banks	-	-	69	69
Loans and advances 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

There was no movement between levels in 2018.

Notes to the Financial Statements (continued)

25. 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 following amounts represent the transactions and outstanding balances with EBS:

- Loans from EBS at 31 December 2018 are €729m (2017: €1,723m).
- Deposits placed with EBS at 31 December 2018 are €58m (2017: €56m).
- The value of debt securities in issue to EBS at 31 December 2018 are €2,538m (2017: €2,022m).
- Service charge payable to EBS for 2018 €57m (2017: €104m).

At 31 December 2018, there were no derivative transactions between the Bank and AIB p.l.c.

	2018 **€m**	2017 €m
Loans and advances to banks	**58**	56
Deposits by banks	**729**	1,723
Included in the Income Statement		
Interest Income	**3**	
Interest expense	**(7)**	(13)
Administrative expenses	**(57)**	(104)
Derivative financial instruments		
Interest rate swaps		
Assets (Fair value)	**23**	20
Liabilities (Fair value)	**23**	20
Net Trading Income	**2**	2
Debt securities to EBS	**2,538**	2,022

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.

Notes to the Financial Statements (continued)

25. 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 including individuals employed by AIB p.l.c.. As at 31 December 2018 the Bank had 8 KMP (2017: 12 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 7 Directors in office during the year, none of whom availed of credit facilities (2017: 0).

(ii) Connected persons
The aggregate of loans to connected persons of Directors in office at 31 December 2018, as defined in Section 220 of the Companies Act 2014, are as follows (aggregate of 1 person; 2017: 1):

	Balance at 31 December 2018	Balance at 31 December 2017
	€ 000	€ 000
Loan	**141**	148
Total	**141**	148
Interest Charged during the year*	**2**	2
Maximum debit balance during year*	**148**	154

*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.

As required on transition to IFRS 9, an expected credit loss allowance (ECL) was created for all loans and advances. Accordingly, an insignificant ECL was created on 1 January 2018 and is held on the above facilities at 31 December 2018. All facilities are performing to their terms and conditions.

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 2018, the State held 71.12% of the ordinary shares of AIB Group plc (31 December 2017: 71.12% 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)

26. COMMITMENTS

At 31 December 2018 the Bank had €9m (2017: €12m) of approved mortgage loan applications that had not been drawn down as at the financial year end.

27. NON-ADJUSTING EVENTS AFTER REPORTING PERIOD

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

28. 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.

29. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on the 26 March 2019.