EBS MORTGAGE FINANCE

Directors' Report and
Annual Financial Statements
for the financial year ended 31 December 2019

Contents

Directors and Other Information	2
Directors' Report	3
Risk Management Report	10
Directors' Responsibility Statement	49
Independent Auditors' Report to the Members of EBS Mortgage Finance	50
Income Statement	56
Statement of Comprehensive Income	56
Statement of Financial Position	57
Statement of Cash Flows	58
Statement of Changes in Shareholders' Equity	59
Notes to the Financial Statements	60

Directors' and Other Information

Directors	Helen Dooley Chris Curley Paul Owens Gerry Gaffney Yvonne Hill	AIB Group Non-Executive Director and Chair Executive Director (Managing Director) Independent Non-Executive Director Executive Director Independent Non-Executive Director
Secretaries	Diane Lumsden Brian Kearns	
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 Ireland	
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 (the "Bank") present their Directors Report (the "Report") and audited financial statements for the financial year ended 31 December 2019. A Directors' Responsibility Statement in relation to the financial statements appears on page 49.

Principal activities

The Bank, a public unlimited company, registered and domiciled in Ireland, is a subsidiary of EBS d.a.c. ("EBS"), wholly owned subsidiary of Allied Irish Banks, p.l.c. ("AIB") which is a wholly owned subsidiary of AIB Group plc ('AIB Group'). The Bank 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 8 February 2006. The Bank was 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'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).

In 2019, the Bank's ultimate parent AIB reviewed the role of the Bank within the wider AIB Group and concluded that the Bank should commence planning to transfer all assets back to EBS. A project is underway with a view to completing this activity by end 2020.

In the meantime the business strategy for 2020 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 Bank's cover pool management, Asset Covered Securities Acts and rating agency requirements for such period as required by AIB.

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 between EBS d.a.c. and AIB. AIB, as Service Provider, 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.

During the majority of 2019, there were 5 Directors on the Board, two of whom were Independent Non-Executive Directors. The Board also included two Executive Directors, one of whom is the Managing Director and one other Director who, while also an employee of AIB, was deemed to be a Non-Executive Director by virtue of the role fulfilled in the area of AIB being unrelated to the operations of the Bank.

The Board is responsible for ensuring that appropriate systems of internal controls and risk management are maintained, specifically the Board sets the Risk Appetite Statement, approves the Risk Framework and approves the annual financial plans. The Bank benefits as a subsidiary of AIB from the wider AIB governance and operating structure, such as oversight of audit and risk related activities. AIB and EBS provide services to the Bank through a formal Managed Services Agreement, updates in respect of the performance against which are provided to the Board regularly. In the event that material failings or weaknesses in the systems of risk management or internal control are identified, an explanation of the issue and an assessment of its impact is presented with a proposed remediation plan to the Board. Agreed remediation plans are tracked to conclusion, with status updates provided to the Board. Given the work of the Board and representations made by the Management Team during the year, the Board is satisfied that the necessary actions to address any material failings or weaknesses identified through the operation of the risk management and internal control framework have been taken, or are currently being undertaken.

Directors' Report

Corporate Governance *(continued)*

The Board of Directors (continued)

The Bank 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 receives regular updates on the Bank's risk profile through the quarterly risk report and, during 2019, 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 Requirements") which imposes minimum core standards upon all credit institutions licensed or authorised by the CBI. The Bank is designated as a "high impact institution" for the purposes of the Requirements. The Bank sought and received derogations from a number of the obligations imposed on high impact institutions, namely:

- Derogation granted from the requirement for the board of the Bank to have seven directors on the basis that it continues to be of sufficient size and expertise to oversee adequately the operations of the credit institution
- Derogation granted from the requirement for the board of the Bank to have at least three independent non-executive directors (INEDs) on the basis that the board of AIBMB continues to have at least 2 independent INEDs
- Derogation granted from the requirement to have an external evaluation of Board effectiveness carried out every three years, on the basis that the Bank continues to conduct an internal review of its own performance and that of its individual directors annually and that this exercise is led by the Chairman.
- Derogation granted from the requirement for the Board to meet at least six times per calendar year, on the basis that the Board will continue to meet at least four times per calendar year and at least once every quarter.
- Derogation granted to the Bank to rely on the following AIB Committees: AIB Audit Committee, AIB Board Risk committee, AIB Remuneration Committee and AIB Nomination and Corporate Governance Committee.
- Derogation granted from the requirement for cross committee membership on the basis that EBS has only one sub-committee.

The Bank has received approval from the CBI that the Chief Risk Officer ("CRO") of AIB Group acts as the CRO of the Bank on an outsourced basis and a Designated Risk Representative ("DRR") has been appointed for the Bank for maintaining and monitoring the effectiveness of the credit institution's risk management system. The appointed DRR has a direct reporting line to the CRO.

The Bank was deemed to be materially compliant with the provisions of the Requirements throughout 2019.

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 as per the derogation received from the CBI from the requirement to establish one.

The Board considers all audit matters including, inter alia:

- The quality and integrity of the Bank's accounting policies, financial and narrative reports and disclosure practices;
- The independence and performance of the External Auditor ("the Auditor") and Internal Audit, duly liaising with the AIB Group Board Audit Committee on matters in relation to the Auditor and Internal Audit, as necessary;
- The adequacy of arrangements by which staff may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters and the effectiveness of the Bank's internal control, risk management, and accounting and financial reporting systems.

These responsibilities are discharged through its meetings with and receipt of reports from management including Finance, Internal Audit, Risk, and Compliance. During 2019, amongst other activities, the Board reviewed the Bank's annual financial statements, and related accounting policies, key judgements, and practices; reports on compliance; the effectiveness of internal controls; including the effectiveness of controls operated under the Managed Services Agreement, and the findings, conclusions and recommendations of the Auditor and Internal Auditor. The Board satisfied itself through regular reports from the Internal Auditor, Risk, Compliance and the Auditor that the system of internal controls was effective.

Directors' Report

Results for the year

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

	2019	2018	
Net interest income ('NII')	**€106m**	€122m	Reduction in NII of €16m driven by lower interest earning balances as the loan book pays down.
Administrative expenses	**€38m**	€71m	In 2019, expenses decreased by €33m driven by a reduction in the Transfer Pricing service charge due to AIB of €20m, together with a reduction of €10m in Tracker Mortgage Examination costs.
Profit before tax	**€34m**	€45m	The decrease in profit before tax is driven by the impact of updates to the inputs of Return on Equity transfer pricing methodology.
Loans & advances to customers	**€3,609m**	€4,048m	In 2019 mortgage balances fell by €439m, due to a reduction in gross mortgage book of c. €449m, as a result of repayments & restructures. This is offset by reduction in provision stock of c. €10m primarily due to reductions in stage 3 loans.
Deposits by banks	**€649m**	€729m	Borrowings from EBS are lower at December 2019 by €80m due to a reduction in the Bank's net funding requirement, driven by lower customer loan balances €439m and 2019 profit after tax €30m, partially offset by capital distribution of €400m in 2019.

Business review

The Irish economy improved during 2019 including a decreasing unemployment rate standing at 4.8% at the end of December 2019 against 5.3% in 2018 (Source: Central Statistics Office). Total mortgage market drawdowns in Ireland were €9.5bn in 2019 compared with €8.7bn in 2018 (Source: Banking and Payments Federation Ireland).

Construction output was up by 2.4% in the first three quarters of the year, driven by the continuing pick-up in house building activity. New house completions rose by 18% to 21,241 in 2019, up from 17,952 in 2018. Housing completions as reported by the CSO, rose by 18.3% to over 21,000 units in 2019, up from 18,000 the previous year. There was a continued increase in planning permissions in 2019, with the number up by almost 32% in Q3 from 2018 levels

The CSO Residential Property Price Index showed an increase in prices nationally of 0.9% in the 12 months to December 2019 (6.5% in 2018). Residential Property Prices outside Dublin in 2019 saw an annual increase of 2.8% (December 2018 9.6%). Property prices in Dublin decreased in the 12 month period by 0.9% (increase of 3.8% in 2018). The residential property price fall from peak (February 2007) was 22.1% Dublin and 20.3% non-Dublin at 31 December 2019 (2018: 21.4% Dublin and 22.0% non-Dublin).

The Bank's loan portfolio before loss allowance decreased by 11% during 2019 to €3.7bn as at 31 December 2019 principally because repayments, loan sales and restructures exceeded loans granted during the year and non-contracted write-offs (2018: decrease of 12%).

The Bank's residential mortgage portfolio comprises gross loan balances of €3.7bn (2018:€4.2bn) €3.7bn Owner-Occupier (2018: €4.2bn) and €0.01bn Buy-To-Let mortgages (2018: €0.01bn).

Tracker Mortgage Examination

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. 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 Bank. Accordingly, the Bank have not made any provision at this stage in relation to these matters.

Asset Quality

Loans and advances to customers (before impairment loss allowances) amounted to €3.7bn at 31 December 2019 (2018: €4.2bn). Non-performing loans decreased from €558m at 31 December 2018 to €458m at 31 December 2019. This reduction was achieved through redemptions and repayments from customers, loan restructuring activity including non-contracted write-offs and asset sales/disposals.

Directors' Report

Business Review *(continued)*
Asset Quality *(continued)*
Expected credit losses measured under IFRS 9 are €0.1bn (2018: €0.1bn). 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 very favourable technical market backdrop for covered bonds in 2019. The ECB has ended net new purchases but is continuing to reinvest funds from maturing bond under the covered bond purchase programme (CBPP3). The ECB has been buying 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 21st February 2020, the holdings under CBPP3 were to c. €270bn (end Jan'19: c. €262.5bn). The ECB forward guidance indicates that interest rates will remain at their current very low levels but it is undergoing a strategic review of policy under its new chairperson. The ECB deposit rate stands at (0.4%).

Covered bond spreads tightened over the course of 2019, as the overall technical backdrop remained very supportive and large fund inflows meant there was an appetite for assets across the credit curve. The Bank did not issue covered bonds to external market investors in 2019 in line with AIB's overall funding priorities and plan.

At 31 December 2019, the total amount of principal outstanding in respect of mortgage covered securities issued was €2.5bn (31 December 2018: €2.5bn) subscribed for in full by EBS.

The ratings as at 31 December 2019 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**	**A2**	**A2**

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 Moody's at Aaa.

Share Capital
The share capital of the Bank is €138m (2018: €552m), comprised of ordinary shares of €0.25 (2018; €1) each.

In 2019 the Bank completed a review of the level of capital required and the Board sought and received approval from the regulator to implement a capital reorganisation, including the payment of excess capital to EBS. This exercise was completed in June 2019 and involved a reduction in the par value of each of the 552m issued shares from €1 to €0.25, thereby reducing Bank's issued share capital by €414m, a payment of €400m to EBS and a transfer of the residual reduction amount of €14m to reserves.

Information on the structure of the Bank's share capital, including the rights and obligations attaching to each class of shares, is set out in note 21 to the financial statements.

Capital resources and regulatory capital ratios
The objectives of the Bank's capital management policy are to at all times comply with regulatory capital requirements and to ensure that the Bank has sufficient capital to cover the current and future risk inherent in its business and to support its future development. Bank's minimum CET 1 requirement

The Bank's minimum CET1 requirement is 8.0%, comprised of a Pillar 1 requirement of 4.5%, Capital Conservation Buffer ("CCB") of 2.5% and a Countercyclical Capital Buffer ("CCyB") of 1.0%. The minimum requirement for the total capital ratio is 11.0%.

At 31 December 2019 the fully loaded CET1 ratio was 27.9% (2018: 43.0%). The fully loaded total capital ratio was 27.9% (2018: 43.0%). The decrease in the ratio was driven by a distribution of €400 million to the immediate parent EBS d.a.c. This was completed in June 2019.

At 31 December 2019 the transitional CET1 ratio was 27.9% (2018: 43.0%), the transitional total capital ratio was 27.9% (2018: 43.0%). The decrease was driven by the distribution detailed above.

The capital ratios do not include profits for 2019. Profits will be included when an application for their inclusion is approved by the European Central Bank under Article 26(2) of the Capital Requirements Regulation.

Directors' Report

Leverage ratio

The leverage ratio at 31 December 2019 was 12.8% (2018: 20.17%) on a fully loaded basis and 12.8% (2018: 20.17%) on a transitional basis. The reduction in the leverage ratio compared to 2018 under both fully loaded and transitional basis is due to lower total capital following a €400m capital distribution in 2019.

Risk Management

The Bank adopts the same risk management framework and risk mitigation initiatives as AIB. The risk management framework provides a Group-wide definition of risk and lays down principles of how risk is to be identified, assessed, measured, monitored and controlled / mitigated, and the associated allocation of capital against same. Further information in relation to Risk Management, including the principal risks and uncertainties facing the Bank, as required under the terms of the European accounts Modernisation Directive (2003/51/EEC) (implemented in Ireland by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005) is set out in the Risk Management Report on pages 10 to 48 and included the following:

- Credit risk;
- Funding and liquidity risk;
- Capital adequacy risk;
- Market risk;
- Operational risk;
- Regulatory compliance risk
- Conduct risk
- People and culture risk;
- Business model risk;
- Model risk

Outlook for 2020

Leading indicators of Irish economic activity softened in 2019 as the world economy lost momentum. Nonetheless, at the start of 2020 the prospects remained favourable for the Irish economy in 2020. Growth was expected to be underpinned by continuing low interest rates, rising employment and incomes, the ongoing rebound in housing activity, as well as a mildly expansive stance to fiscal policy. This was expected to result in a solid rise in new lending activity in 2020.

The outlook noted above has been impacted by the recent coronavirus outbreak (COVID-19) which is an emerging and potentially significant risk that the Bank and AIB are monitoring closely. The outbreak is expected to impact the economies or markets to which the Bank or our customers are exposed, and is likely to impact on the Bank's performance. AIB has established a monitoring group to assess the range of possible impacts, recognising emerging Irish Government supports and regulatory guidance and will continue to respond to the situation as it evolves. Any impact will depend on future developments, which are highly uncertain. A priority of the Bank will be to support mortgage customers who may experience short term financial difficulty as a result of COVID-19 with short term modifications to repayment arrangements.

The European Commission has proposed a dedicated EU framework for covered bond harmonisation incorporating a Covered Bond Directive to be transposed into national law by June 2021. The Banking & Payments Federation Ireland's ACS group is currently analysing the elements of the directive that provide for national discretion with the aim of making a submission to the Department of Finance. However this Directive can be transposed into law on its own without any amendments.

Brexit

The UK left the EU on 31 January 2020 after Parliament approved a revised Withdrawal Agreement. This includes a transition period to end 2020, during which time the existing EU trading rules will remain in place. The UK hopes to conclude a trade deal with the EU before end 2020 that will frame the basis for its future trading relationship with Europe. These trade talks are likely to prove very difficult. Considerable uncertainty will persist about Brexit until the future trading relationship is finalised.

Going concern

The financial statements for the financial year ended 31 December 2019 have been prepared on a basis other than that of going concern as the Directors intend to complete a transfer of the business of the Bank to its' sole shareholder. The Directors do not believe that the Bank will continue in existence for the foreseeable future.

While the directors' intention is to wind up the entity no actions have been taken to commence this process. On that basis the measurement and recognition under IFRS is unchanged under the basis other than going concern

Directors' Report

Directors' and Secretary's interests in shares
The Directors and Bank Secretary did not hold any interests in the Bank's shares or debentures 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. There were no changes in the Directors' and Bank Secretary's interests between 31 December 2019 and 25 March 2020.

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 Bank Secretary at 31 December 2019. Independent Non-Executive Directors do not participate in long term incentive plans.

Attendance at scheduled Board Meetings during 2019

Name	**Board (Scheduled)**		**Board (Out of Course)**		**Board Audit Committee (Scheduled and Out of Course)**	
Directors	**Eligible to Attend**	**Attended**	**Eligible to Attend**	**Attended**	**Eligible to Attend**	**Attended**
Chris Curley	4	4	4	4	—	—
Gerry Gaffney	4	4	4	4	—	—
Helen Dooley	4	4	4	4	—	—
Brendan McDonagh	4	4	4	2	—	—
Jim O' Hara	4	4	4	4	—	—

Directors and Secretaries
The following were Directors of the Bank during 2019 - Chris Curley, Gerry Gaffney, Brendan McDonagh, Helen Dooley (chair) and Jim O Hara.

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

Paul Owens and Yvonne Hill were each appointed as a Director of the Bank on 23 January 2020.

Jim O'Hara resigned as a Director of the Bank on 30 January 2020.

Brendan McDonagh resigned as Director of the Bank on 11 March 2020.

The Bank Secretary during the year was Diane Lumsden and Brian Kearns was appointed as a Joint Secretary of the Bank on 1 February 2019.

Cara Teahan resigned as a Secretary on 1 February 2019.

Dividend
There was no interim dividend paid to the shareholder during 2019 and the Board is not recommending the payment of a final dividend for 2019 (2018: no dividend paid).

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

Branches outside the State
The Bank has not established any branches outside the State.

Disclosure notice under Section 33AK of the Central Bank Act 1942
The Bank did not receive a Disclosure Notice under Section 33AK of the Central Bank Act 1942 during 2019.

Directors' Report

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.

Events after the reporting period
There have been no significant events affecting the Bank since the reporting date which require amendment to, the financial statements.

Coronavirus outbreak
The recent coronavirus outbreak (COVID-19) which is an emerging and potentially significant risk that the Bank and AIB are monitoring closely. The outbreak is expected to impact the economies or markets to which the Bank or our customers are exposed, and is likely to impact on the Bank's performance. AIB has established a monitoring group to assess the range of possible impacts, recognising emerging Irish Government supports and regulatory guidance and will continue to respond to the situation as it evolves. Any impact will depend on future developments, which are highly uncertain.

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 AIB's Auditors are unaware; and
(b) the Director has taken all steps that they ought to have taken as a Director in order to make themselves aware of any relevant audit information and to establish that AIB's Auditors are aware of that information.

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

Independent auditor
Deloitte Ireland LLP, Chartered Accountants & Statutory Audit Firm were appointed as auditors 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

Chris Curley
Managing Director

Date: 25 March 2020

Risk Management Report

1. Introduction

All of the Bank's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed across AIB. 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 facing AIB and adopts the same risk mitigation initiatives as AIB.

2. Risk management framework

The Bank relies on AIB's 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 Funding and liquidity risk;
3.3 Capital adequacy risk;
3.4 Market risk;
3.5 Operational risk;
3.6 Regulatory compliance risk;
3.7 Conduct risk;
3.8 People and culture risk;
3.9 Business model risk and;
3.10 Model risk.

3.1 Credit risk

Credit risk is the risk that the Bank will incur losses as a result of a customer or counterparty being unable or unwilling to meet their contractual obligations.

Based on the annual risk identification and materiality assessment, credit risk can be categorised into the following three sub categories;

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; and
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:

– 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 risk appetite statement and generate appropriate returns on capital within acceptable levels of credit quality.
– 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.
– 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.
– Operate within a sound and well defined credit granting process, where risks for new and existing lending exposures are identified, assessed, measured, managed and reported in line with risk appetite and the credit risk policy.
– 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.
– Ensure sound methodology exists to proactively assess risk and to identify deteriorating credit quality to minimise losses and maximise recoveries in work out scenarios.
– Utilise management information and risk data, of appropriate quality 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.
– 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 a credit assessment process. The role of the Credit Risk function is to provide direction, independent oversight and challenge of credit risk-taking.

Bank Risk Appetite Statement

The Bank's Risk Appetite Statement ("RAS") process sets the amount and nature of risks that the Bank is willing to accept within its risk capacity in pursuit of its financial objectives and informs both Bank strategy and policies. As part of the overall framework for risk governance, it forms a boundary condition to strategy and guides the Bank in its risk-taking and related business activities. Credit risk appetite is set at AIB Board level and is described, reported and monitored through a suite of qualitative and quantitative metrics. Risk appetite is stress tested to ensure limits are within the risk-taking capacity of the Bank. The Bank's risk appetite for credit risk is reviewed and approved at least annually.

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 relies on the AIB credit risk framework and its supporting policies, processes and governance. The AIB Credit Risk Framework and the AIB Credit Risk Policy are overarching AIB Board approved documents which set out the principles of how AIB 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 AIB to provide a common, robust and consistent approach to the management of credit risk.

The AIB 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.

* Forms an integral part of the audited financial statements

3.1 Credit risk

Credit risk principles and policy* *(continued)*

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.

Credit approval overview

The Bank operates credit approval criteria which:
- Includes a clear indication of the Bank's target market(s), in line with its risk 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 standards and facility structuring standards.

Credit risk approval is undertaken by professionals operating within a defined delegated authority framework. At an AIB Group level the AIB Board is the ultimate credit approval authority. The Board has delegated credit authority to various credit committees and to the Chief Credit Officer (CCO).The CCO is permitted to further delegate this credit authority to individuals within the Group on a risk appropriate basis. Credit limits are approved in accordance with the AIB'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*

As part of the credit approval process and ongoing review process, 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 of default (PD through the cycle) are derived.

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. In line with the Bank's credit management cycle, heightened 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.

Using internal models, the Bank has designed and implemented a credit grading masterscale that gives it the ability to categorise and contrast credit risk across different rating models and 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/default loans. Page 30 sets out the profile of the Bank's loan portfolio under each of the above grade categories.

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.

* Forms an integral part of the audited financial statements

3.1 Credit risk

Internal credit ratings* *(continued)*

In addition to the internal credit ratings as outlined above, 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 17 to 25.

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', '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). This alignment ensures consistency with the Bank's internal credit risk management and assessment practices.

These 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, or
– The credit obligor is 90 days or more past due on any material credit obligation. Day count starts when 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. The Bank's definition of financial distress, forbearance, non-performing exposures and unlikelihood to pay are included in the Bank's Definition of Default policy.

Non-performing loans are analysed by the following categories on page 31:

Unlikely to pay – 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.
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 – Where the credit obligor, 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, subject to meeting defined probation criteria.

Credit risk monitoring*

The Bank 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 the Bank'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 credit risk exposures at a transaction and relationship level. Monitoring includes credit exposure and excess management, regular review of accounts, being up to date with any developments in customer business, 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.

The Bank 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 / early warning list, the exposure is carefully monitored and where appropriate, exposure reductions are effected. In addition, exceptions to credit policy are reviewed regularly.

Through a range of forbearance solutions as outlined on pages 31 and 32, the Bank employs a dedicated approach to loan workout, monitoring and proactive management of non-performing loans. A specialised recovery function focuses on managing the majority of criticised loans and deals with customers in default, collection or insolvency. Their mandate is to support customers in difficulty while maximising return on non-performing loans.

* Forms an integral part of the audited financial statements

3.1 Credit risk- Credit exposure

Credit risk mitigants*

The perceived strength of a borrower's repayment capacity is the primary factor in granting a loan. However, the Bank 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 a 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 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 a 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:

– Mortgages over residential real estate

The nature and level of collateral required depends on a number of factors such as the type of the credit facility, the term of the credit facility and the amount of exposure. Collateral held as security for financial assets other than for 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 the valuation of property collateral held by the Bank.

In accordance with the AIB's Property Valuation Policy and Guidelines, 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 AIB'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.

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk - Credit exposure
Credit risk mitigants* *(continued)*
Collateral and ECLs

Applying one or a combination of the above methodologies, in line with the AIB'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. 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.

The following tables show the estimated fair value of collateral held for the Bank's residential mortgages at 31 December 2019 and 2018:

					2019
	Measured at amortised cost				
	Stage 1	Stage 2	Stage 3	POCI	Total
	€ m	€ m	€ m	€ m	€ m
Fully collateralised[1]					
Loan-to-value ratio:					
Less than 50%	1,174	92	144	10	1,420
50% - 70%	869	113	96	22	1,100
71% - 80%	332	45	40	11	428
81% - 90%	292	43	28	13	376
91% - 100%	219	39	34	9	301
	2,886	332	342	65	3,625
Partially collateralised					
Collateral value relating to loans over 100% loan-to-value	33	13	41	4	91
Total collateral value	2,919	345	383	69	3,716
Gross carrying value residential mortgages	2,922	345	389	72	3,728
Loss allowance	(1)	(11)	(96)	(11)	(119)
Carrying value residential mortgages	2,921	334	293	61	3,609

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

* Forms an integral part of the audited financial statements

3.1 Credit risk - Credit exposure
Credit risk mitigants* *(continued)*
Collateral and ECLs *(continued)*

	2018				
	Measured at amortised cost				
	Stage 1	Stage 2	Stage 3	POCI	Total
	€ m	€ m	€ m	€ m	€ m
Fully collateralised[1]					
Loan-to-value ratio:					
Less than 50%	1,189	107	87	9	1,392
50% - 70%	898	128	97	21	1,144
71% - 80%	402	52	50	11	515
81% - 90%	309	46	42	12	409
91% - 100%	290	51	47	11	399
	3,088	384	323	64	3,859
Partially collateralised					
Collateral value relating to loans over 100% loan-to-value	102	34	134	6	276
Total collateral value	3,190	418	457	70	4,135
Gross carrying value residential mortgages	3,194	421	488	74	4,177
Loss allowance	(1)	(11)	(109)	(8)	(129)
Carrying value residential mortgages	3,193	410	379	66	4,048

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

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 2019 and 2018 is estimated based on property values at origination or date of latest valuation and applying the CSO Residential Property Price Index to these values to take account of price movements in the interim.

Derivatives
Derivative financial instruments are recognised in the statement of financial position at their fair value. Those with a positive fair value are reported as assets which at 31 December 2019 amounted to €21m (2018: €23m) and those with a negative fair value are reported as liabilities which at 31 December 2019 amounted to €21m (2018: €23m).

Loans and advances to banks
Interbank placings, including central banks, are largely carried out on an unsecured basis apart from reverse repurchase agreements. However, there were no repurchase agreements outstanding at 31 December 2019 (2018: nil).

* Forms an integral part of the audited financial statements

3.1 Credit risk

Measurement, methodologies and judgements*

Introduction

The Bank has set out the methodologies used and judgements exercised in determining its expected credit loss ("ECL") allowance for the year to 31 December 2019.

International Financial Reporting Standard 9 (IFRS 9) introduced the expected credit loss impairment model that requires a more timely recognition of ECL across the Bank. The standard does not prescribe specific approaches to be used in estimating ECL allowances, 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.

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.

The ECL model applies to financial instruments measured at amortised cost or at fair value through other comprehensive income. In addition, the ECL approach applies to loan commitments that are not measured at fair value through profit or loss.

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.

Bases of Measurement

Under IFRS 9, there are two bases of measurement:

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; and
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(POCI) criteria.

Staging

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.

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk
Measurement, methodologies and judgements* ***(continued)***
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 in credit risk has occurred on its financial obligations since their initial recognition. This assessment is performed on individual obligations 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.

SICR assessment
The Bank's SICR assessment is determined based on both Quantitative and Qualitative measures:

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 transfers the financial obligation into Stage 2. Increases in LTPD may be due to credit deterioration of the individual obligation or due to macroeconomic factors or a combination of both. On adoption of IFRS 9, the Bank has determined that an account had met the quantitative measure if the average residual LTPD at the reporting date was more than double the average residual LTPD at origination, and the difference between the LTPDs was at least 50bps.

The impact of this measure is under regular review by the Bank for items such as the (i) volume of exposures moving frequently between Stages 1 and 2, (ii) potential over-reliance on backstop and qualitative measures for identifying Stage 2 exposures and (iii) comparison of Stage 1 and 2 exposures to the internal credit ratings view of exposures. In 2019, following an assessment of mortgage exposures including the items above, a change to the quantitative SICR threshold from 50bps to 85bps was approved by the Bank. This was implemented in the residential mortgage portfolio at December 2019.

Qualitative measure: This measure reflects the assessment of the change in credit risk based on the Bank's credit management of 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 including monitoring of account activity 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/or
– Forbearance has been provided and the account is within the probationary period.

Backstop indicators: The Bank has adopted the rebuttable presumption 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 the account can exit Stage 2 and return to Stage 1.

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, or
– The credit obligor is 90 days or more past due on any material credit obligation (count starts when 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, non-performing exposures and unlikeliness to pay are included in the Bank's Definition of Default policy.

Loans may return to Stage 3 if any of the default triggers reoccur.

* Forms an integral part of the audited financial statements

3.1 Credit risk

Measurement, methodologies and judgements* ***(continued)***

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 effective interest rate. This rate is used to discount the expected cash flows of such assets to fair value on initial recognition.

POCI obligations remain outside of the normal stage allocation process for the lifetime of the obligation. The ECL for POCI obligations 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 portfolios not on the standard approach, 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 considered appropriate for an adjustment to ECL. The management adjustment must consider all relevant and supportable information, including but not limited to, historical data analysis, predictive modelling and management experience. 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.

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. 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

The Bank utilises the practical expedient, as allowed by IFRS 9, 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.

* Forms an integral part of the audited financial statements

3.1 Credit risk
Measurement, methodologies and judgements* ***(continued)***
Low credit risk exemption ***(continued)***
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.

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 12, 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.

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
Both the origination date and the expected maturity of a facility must be determined for ECL purposes. The origination date is used to measure credit risk at origination (as explained above).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.

Forward looking indicators in models
For ECL calculations reliant on models in the standard and simplified approaches, forward looking indicators are incorporated into the models through the use of macroeconomic variables. These have been identified statistically as the key macroeconomic variables that drive the parameter being assessed (e.g. PD or LGD). The final model structure incorporates these as inputs with the 12 month and lifetime calculations utilising the macro-economic forecasts for each scenario. See 'macroeconomic scenarios and weightings' below for more detail on the process for generating scenarios and associated key macroeconomic factors relevant for the models

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. The Bank determines, based on a specific criteria, 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).

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk
Measurement, methodologies and judgements* ***(continued)***
Write-offs* ***(continued)***
The contractual amount outstanding of loans written off during the year that are still subject to enforcement activity are outlined on page 38 and relate to non-contracted write-offs, both full and partial.

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 ECL allowance calculations are subject to AIB Group's governance process covering the development and approval of macro-economic scenarios for planning and stress testing i.e. through AIB Stress Test Working Group and Asset and Liability Committee (ALCo). The parameters used within AIB Group's ECL models include macro-economic factors which are established drivers of the default risk and loss estimates. Therefore, a different credit loss estimate is produced for each combination of macroeconomic factors within a particular scenario. These credit loss estimates for each given scenario are then weighted by the assessed likelihood of occurrence of the respective scenarios to yield the ECL outcome.

Macro-economic scenarios:
AIB Group's approach is to use its base, downside (both 'disorderly Brexit' and 'global slowdown') and upside macro-scenarios from the financial planning and stress testing processes for IFRS 9 purposes. The inclusion of a fourth scenario in 2019 ('global slowdown') was deemed necessary to ensure that different triggers of downside outcomes are available given the continued uncertainty over the Brexit process. The use of current planning scenarios ensures that the scenarios used for IFRS 9 are consistent with the Bank's 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 a single upside and two downside scenarios. AIB Group's Economic Research Unit provide base, downside and upside forecasts over five years for planning/ IFRS 9. These are then independently reviewed and challenged, on both a quantitative and qualitative basis, by the AIB Group Enterprise Risk Management (ERM) function. 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 based on realistic triggers for each scenario and represent 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 Group ALCo and on an annual basis by AIB Board. The scenarios are described below and reflect the views of AIB Group and the Bank at the reporting date.

Base case: As at the reporting date, this reflects an 'orderly' Brexit outcome. Under this scenario the Irish economy continues to perform strongly in the absence of external shocks, helped by very low interest rates, mildly expansionary fiscal policy, solid growth in exports, recovering construction sector and good growth in employment and real incomes. However, some deceleration from the very robust growth rates seen in recent years is likely as the economy is now close to full employment and given the slowdown in growth in Ireland's key export markets. Irish house price inflation has decelerated over the past year reflecting the impact of the Central Bank's macro-prudential rules on mortgage lending and supply. House prices are expected to rise at low single digit levels, broadly in line with wage inflation over the next five years. The rate of increase in commercial real estate prices is expected to run at low single digit levels as the market moves closer to equilibrium.

Under an orderly Brexit, the UK economy is not expected to suffer any significant disruption and will perform at close to its long-term potential. In terms of the US economy, growth in GDP is expected to slow as a result of the diminishing effects of the significant fiscal stimulus, a slower pace of global growth and capacity constraints in the 'full-employment' labour market. Growth in the eurozone is expected to improve slightly over the forecast period.

Downside ('disorderly' Brexit): Under this scenario, the UK exits the EU in a disorderly manner and has to apply to World Trade Organisation (WTO) rules. There is a significant slowdown in Irish GDP in this period as a result of the deep links between the two economies with 40% of indigenous Irish exports going to the UK, which is also the land bridge route for much of Irish exports to mainland Europe. These exports (as well as imports from the UK) all become subject to customs checks, tariffs, increased administration as well as regulatory costs and transport delays. As a result, the scenario assumes that Irish GDP growth is lower in a 'disorderly' Brexit scenario than in the base case over the three years to 2022 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).

A 'disorderly' 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 Foreign Direct Investment ("FDI"). The UK economy enters recession during this period. The impact on the EU is limited as less than 10% of EU exports go to the UK and the impact on the US is even more limited.

* Forms an integral part of the audited financial statements

3.1 Credit risk

Measurement, methodologies and judgements* ***(continued)***

Downside ('global slowdown'): Under this scenario the global economy continues to lose momentum. The key triggers for this under this scenario are:
- a continued move towards protectionism, which would result in further escalation in trade tensions;
- an increase in risk aversion, which would cause large asset price shifts and financial market instability; and
- an 'orderly' Brexit outcome

In the next three years, large developed European economies would enter a mild recession while activity in the US is subdued. For the Irish economy, given the importance of exports as an engine of growth, the slowdown in the international economy has a significant impact. FDI is also adversely affected with business and consumer confidence lowered as a result. There is a slowdown in the recovery of house building and GDP growth over the first 3 years is significantly lower than in the Base case. Irish house prices register modest declines - the scarcity of supply and the fact that the economy continues to see some growth help support the market, although some foreign institutional investors reduce their exposure.

Upside: Under this scenario, given the moderate pace of growth in the current cycle since the end of the 2008-09 recession, there is scope for stronger growth in activity over the next number of years than is forecast in the base case. The lagged effects of very loose monetary conditions, with central banks able to maintain interest rates at low levels because of subdued inflation, would see growth strengthen above trend in advanced economies, helped also by an improvement in productivity and a recovery in international trade as tensions in this area subside. Additionally, other countries could follow the lead of the US and adopt a more expansionary fiscal programme of increased capital spending and tax cuts to boost growth, most notably in Europe. The UK agrees an 'orderly' Brexit with the EU.

Given Ireland's exposure to international trade, a better than expected performance by its key trading partners would have a positive knock-on impact on its exports and in turn, on the rate of growth of the economy. This results in stronger growth on the domestic side of the economy also, helped by a more expansionary fiscal policy stance. House building would also pick up strongly, helped by government measures. As a result Irish growth would exceed the Base case materially over the first three years of the forecast period.

The table below sets out the average five year forecast for each of the key macroeconomic variables that are required to generate the scenarios or are material drivers of the ECL under (i) base; (ii) downside ('disorderly' Brexit); (iii) downside ('global slowdown'); and (iv) upside scenarios at 31 December 2019 and 2018:

	2019				2018		
Macroeconomic factor (%)	**Base**	**Downside ('disorderly ' Brexit)**	**Downside ('global slowdown')**	**Upside**	Base	Downside	Upside
GDP growth	**2.9**	**1.8**	**1.7**	**4.1**	3.3	2.2	4.4
Residential property price growth	**2.6**	**0.2**	**0.5**	**4.6**	4.9	2.7	7.4
Unemployment rate	**4.7**	**7.8**	**7.4**	**4.0**	4.9	7.1	4.5
Commercial property price growth	**2.0**	**-1.8**	**-1.8**	**3.9**	4.0	0.6	6.1

The key changes to the scenario forecasts in the reporting period are:
- Reductions in residential property price growth forecast in Ireland across all scenarios as a result of the increased impact of the central bank's macro-prudential rules on mortgage lending as the property price growth in recent years has resulted in the loan to value ("LTV) and loan to income ("LTI) thresholds becoming more difficult to meet for purchasers; and
- Reductions in the commercial property price growth forecast in Ireland across all scenarios as the market has moved closer to equilibrium;

The four scenarios detailed above are used to reflect a representative sample of possible outcomes (i.e. base, downside ('disorderly' Brexit), downside (global slowdown) and upside scenarios). The ECL allowance reflects a weighted average of the credit loss estimates under the four scenarios.

Similar to the scenario forecasts, the probability weight assigned to each scenario is proposed by the ERU, with a review and challenge from ERM. These are subject to review at AIB Group ALCo and the probabilities described below reflect the views of AIB Group at the reporting date.

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk

Measurement, methodologies and judgements* *(continued)*

The weights for the scenarios are derived based on the expert judgement, with reference to external market information, informed by a quantitative analysis. The key quantitative analysis is a statistical distribution analysis of Irish GDP growth over different time horizons informed by historic patterns in the economic data.

These weightings were reviewed regularly during 2019.There have been two changes to the probability weightings during the reporting period:

- The probability of the downside scenario (prior to the additional downside scenario being added) was increased by 5% in the third quarter of 2019 to reflect the increased uncertainty in relation to the Brexit process;
- A new downside scenario ('global slowdown') was introduced in the fourth quarter of 2019 which required a full review of the probability weightings in order to incorporate this new scenario. As the UK election has brought increased certainty to the withdrawal element of Brexit this was deemed to have reduced the risk of the 'disorderly' Brexit scenario. A review of the new 'global slowdown' scenario indicated that as risks to the global economy remain to the downside, that this new scenario along with the 'disorderly' Brexit scenario should continue to have a significant probability attached. This reflects the fact that uncertainty, evident at 31 December 2019, in relation to both Brexit and global economic conditions, continues to remain elevated.

The weights that have been applied as at the reporting date are:

Scenario	Weighting	
	31 December 2019	31 December 2018
Base	50%	50%
Downside ('disorderly' Brexit)	25%	35%
Downside ('global slowdown')	15%	N/A
Upside	10%	15%

In assessing the adequacy of the ECL allowance, the Bank has considered all available forward looking information as of the balance sheet date in order to estimate the future expected credit losses. The Bank, through its risk management processes (including the use of expert credit judgement and other techniques) assesses its ECL allowance 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 four 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 which indicate the approximate impact on the current ECL allowance before the application of probability weights to the forward looking macroeconomic scenarios. The sensitivities provide an estimate of ECL movements driven by both changes in model parameters including current management judgements, and quantitative ‘significant increase in credit risk’ (“SICR”) staging assignments.

* Forms an integral part of the audited financial statements

3.1 Credit risk

Measurement, methodologies and judgements* *(continued)*

Relative to the base scenario, in the 100% downside 'disorderly Brexit' and 'global slowdown' scenario, the ECL allowance increases by 31% and 19% respectively. In the 100% upside scenario, the ECL allowance declines by 13%, showing that the ECL impact of the two downside scenarios is greater than that of the upside scenario. For 31 December 2019, a 100% downside 'disorderly Brexit' and 'global slowdown' scenarios sees a higher ECL allowance sensitivity of €33m and €20m respectively compared to base (€22m and €9m respectively compared to reported). This compares to an ECL allowance sensitivity, relative to the base scenario of €18m (€14m reported) for 31 December 2018.

	ECL allowance at 31 December 2019				
	Reported	**100% Base**	**100% downside ('disorderly' Brexit)**	**100% downside (global slowdown)**	**100% upside**
	Total	**Total**	**Total**	**Total**	**Total**
Loans and advances to customers	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**
Residential mortgages	**119**	**108**	**141**	**128**	**94**
Total	**119**	**108**	**141**	**128**	**94**
Off-balance sheet loan commitments	**—**	**—**	**—**	**—**	**—**
	119	**108**	**141**	**128**	**94**

	ECL allowance at 31 December 2018			
	Reported	100% Base	100% downside	100% upside
	Total	Total	Total	Total
Loans and advances to customers	€ m	€ m	€ m	€ m
Residential mortgages	129	125	143	108
Total	129	125	143	108
Off-balance sheet loan commitments	—	—	—	—
	129	125	143	108

Management judgements

The Bank reflects reasonable and supportable information that is available at the reporting date, in the measurement of ECLs.

Management adjustments may be required to increase or decrease ECLs to reflect all available reasonable and supportable information to include risk factors that have not been included in the risk measurement process or where there is insufficient time to appropriately incorporate relevant new information. Experienced credit judgement may be used to determine the particular attributes of exposures that have not been adequately captured in the impairment models. Adjustments are required to be directionally consistent with forward-looking forecast, supported by appropriate documentation and subject to appropriate governance processes. If an ongoing adjustment is required, the risk measurement methodology should be updated to eliminate the adjustment, and as such, should be temporary in nature, where appropriate.

* Forms an integral part of the audited financial statements

3.1 Credit risk

Measurement, methodologies and judgements* ***(continued)***

The ECL allowance on loans and advances to customers at 31 December 2019 includes the following management adjustments:

ROI Primary dwelling house ('PDH') mortgage post model adjustments

Stage 3 PDH ECL

The Bank's strategy is to deliver sustainable long term solutions and to work with customers through their financial difficulties. This has primarily been through work-out arrangements with customers, including split mortgages, low fixed interest rate, voluntary sale for loss, negative equity trade down and positive equity solution or through loan recovery following realisation of collateral. The mortgage LGD model is based on empirical internal data for such resolved cases, and represents the Bank's expected loss based on those expected work-out strategies. However, it is recognised that alternative recovery strategies, such as portfolio sales, also need to be considered which were not envisaged at the time of model development. Accordingly, a post model adjustment has been applied to a cohort of loans to reflect the potential resolution outcomes not currently considered within the modelled outcome.

The post model adjustment is calculated on a range of alternative recovery assumptions (including portfolio sales). An independent external benchmark exercise is undertaken to provide information to support the range of alternative recovery outcomes with reference to collateral values of the loans and to the underlying market conditions. The cohort to which the overlay applies to is primarily those PDH loans in Stage 3 and in deep arrears (greater than 180 days) and was widened in 2019 to include certain loans from the 90 to 180 days past due category (c. € 19m).

Probability weightings are applied to reflect a range of possible outcomes, incorporating potential market uncertainty around the ultimate execution, aligned to the Bank's four economic scenarios used for ECL calculations as outlined on pages 21 to 24.

The ECL allowance of € 119m for residential mortgages at 31 December 2019 includes € 55m as a result of this management adjustment (31 December 2018: €129m and € 60m respectively). The main movements in the overlay during the year were due to:

– Increase in portfolio following widening of the criteria as noted above;
– Reduction in portfolio following sales;
– Revisions to collateral valuations and market conditions; and
– The impact of the outcome of the four economic scenarios compared to the outcome assessed in 2018.

The revised portfolio size and collateral valuations resulted in an income statement charge of € 16m. The greater market and economic uncertainty reflected in the four scenarios resulted in a further € 8m charge. (Total income statement charge in 2019: € 24m).

Forbearance Product

An element of forborne loans in Stage 3 (€ 38m), may require an alternative treatment at loan expiry in line with the Bank's current mortgage resolution strategy. This is not currently captured within the modelled ECL outcome for this product.

Management have considered the proportion of this cohort that may require alternative treatment and a range of quantitative outcomes in determining the estimated loss amounts at loan expiry which has resulted in a post model adjustment of € 5m in 2019 (2018: Nil)

Lifetime Interest only

A cohort of non-defaulted lifetime interest only mortgages have been identified for individual assessment to confirm likeliness to pay (€ 4m). The loans within this cohort have been allocated to Stage 2, pending individual assessment, reflecting management's qualitative judgement of a significant increase in credit risk given the additional end of term risk not fully incorporated into modelled outcomes. This has resulted in a post model adjustment of € 0.2m in 2019 (2018: Nil).

* Forms an integral part of the audited financial statements

3.1 Credit risk

Measurement, methodologies and judgements* *(continued)*

ECL governance

The Board of 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 AIB Group.

The key governance points in the ECL approval process during 2019 were:
- Model Risk Committee
- Asset and Liability Committee
- Business level ECL Committees
- AIB Group Credit Committee, and
- 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 Group Credit Committee (GCC). GCC reviews and challenges ECL levels prior to recommendation to the AIB Board Audit Committee.

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

* Forms an integral part of the audited financial statements

3.1 Credit risk - Credit exposure overview

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 and similar contracts granted, it is the maximum amount the Bank would have to pay if the guarantees were called upon. 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 2019 and 2018:

			2019			2018
	Amortised Cost[(1)]	**Fair Value[(2)]**	**Total**	Amortised Cost[(1)]	Fair Value[(2)]	Total
Maximum exposure to credit risk	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Derivative financial instruments	**—**	**21**	**21**	—	23	23
Loans and advances to banks	**58**	**—**	**58**	75	—	75
Loans and advances to customers	**3,609**	**—**	**3,609**	4,048	—	4,048
	3,667	**21**	**3,688**	4,123	23	4,146
Off balance sheet loan commitments[(4)]	**9**	**—**	**9**	9	—	9
Maximum exposure to credit risk	**3,676**	**21**	**3,697**	4,132	23	4,155

[(1)]All amortised cost items are loans and advances and investment securities which are in a 'held-to-collect' business model.
[(2)]All items measured at fair value except investment securities at FVOCI and cash flow hedging derivatives are classified as 'fair value through profit or loss'.
[(3)]Other assets includes all remaining assets with the exception of deferred taxation.
[(4)] A commitment is an off-balance sheet product, where there is an agreement to provide an undrawn credit facility. The contract may or may not be cancelled unconditionally at any time without notice depending on the terms of the contract.

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk - Credit exposure overview

Credit risk exposure derives from standard on-balance sheet products such as mortgages. In addition, credit risk arises from other products and activities including “off-balance sheet” commitments.

The following table summarises financial instruments in the statement of financial position at 31 December 2019 and 2018:

	2019*				2018*			
	Statement of financial position			**Income statement**	Statement of financial position			Income statement
	Exposure	**ECL allowance**	**Carrying amount**	**Net credit impairment (charge)/ writeback**	Exposure	ECL allowance	Carrying amount	Net credit impairment (charge)/ writeback
	€ m	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m	€ m
Loans and advances to banks	**58**	**—**	**58**	**—**	75	—	75	—
Loans and advances to customers:	**3,728**	**(119)**	**3,609**	**(37)**	4,177	(129)	4,048	(9)
Loan commitments	**9**	**—**	**9**	**—**	9	—	9	—
Total				**(37)**				(9)

There was a €37m net credit impairment charge in the year to 31 December 2019. This comprised of a €37m charge on loans and advances to customers (net re-measurement of ECL allowance charge of €44m, offset by recoveries of amounts previously written-off of €7m) and a nil writeback for off-balance sheet exposures.

Further details on the net credit impairment charge in the 12 months to 31 December 2019 are set out on page 78.

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk - Credit profile of the loan portfolio
The following table analyses the residential mortgage portfolio by ECL staging at 31 December 2019 and 2018:

			2019*			2018*
	Owner-Occupier	**Buy-To-Let**	**Total**	Owner-Occupier	Buy-To-Let	Total
Gross loans and advances to customers	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Total gross carrying amount	**3,720**	**8**	**3,728**	4,167	10	4,177
Analysed as to ECL staging						
Stage 1	**2,917**	**5**	**2,922**	3,187	7	3,194
Stage 2	**344**	**1**	**345**	420	1	421
Stage 3	**388**	**1**	**389**	486	2	488
POCI	**71**	**1**	**72**	74		74
Total	**3,720**	**8**	**3,728**	4,167	10	4,177
ECL allowance - statement of financial position	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m
Stage 1	**(1)**	**—**	**(1)**	(1)		(1)
Stage 2	**(11)**	**—**	**(11)**	(11)		(11)
Stage 3	**(96)**	**—**	**(96)**	(108)	(1)	(109)
POCI	**(11)**	**—**	**(11)**	(8)		(8)
Total ECL allowance	**(119)**	**—**	**(119)**	(128)	(1)	(129)
Total carrying value of Residential Mortgages	**3,601**	**8**	**3,609**	4,039	9	4,048
ECL allowance cover percentage	**%**	**%**	**%**	%	%	%
Stage 1	**—**	**—**	**—**	—	—	—
Stage 2	**3**	**3**	**3**	3	7	3
Stage 3	**25**	**6**	**25**	22	18	22
POCI	**15**	**7**	**15**	10	78	10
Income statement credit impairment charge/(writeback)						
Net remeasurement of ECL allowance	**44**	**—**	**44**			13
Recoveries of amounts previously written-off	**(7)**	**—**	**(7)**			(4)
Net credit impairment (writeback)/ charge	**37**	**—**	**37**			9
	%	**%**	**%**			%
Net credit impairment (writeback)/ charge on average loans	**0.94**	**(0.91)**	**0.94**			0.19%

* Forms an integral part of the audited financial statements

3.1 Credit risk - Credit profile of the loan portfolio

Gross loans and advances to customers

Gross loans and advances to customers reduced by € 449 million in the year to 31 December 2019. The reduction was driven by redemptions net of interest credited of € 408 million and write-offs of € 53 million.

Stage 3 loans decreased by € 99 million to € 389 million. The reduction was primarily as a result of write-offs of € 52 million and repayments of € 43 million.

ECL allowance

The ECL allowance on loans and advances to customers reduced by € 10 million to € 119 million in the 12 months to 31 December 2019. The reduction was predominately in Stage 3 relating to write offs of € 52 million. The ECL cover rate increased to 3.2% from 3.1% primarily due to the post model adjustments approved in December 2019.

Internal credit grade profile by ECL staging

The below table outlines the credit profile of the Bank's loans and advances to customers portfolio and the relationship with staging outcomes. The credit profile reflects AIB's internal credit grading systems and risk classification:

					2019*
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Amortised cost	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**
Strong	**2,589**	**25**	**—**	**1**	**2,615**
Satisfactory	**243**	**29**	**—**	**—**	**272**
Total strong/satisfactory	**2,832**	**54**	**—**	**1**	**2,887**
Criticised Watch	**90**	**156**	**—**	**—**	**246**
Criticised Recovery	**—**	**135**	**—**	**2**	**137**
Total criticised	**90**	**291**	**—**	**2**	**383**
Non-performing	**—**	**—**	**389**	**69**	**458**
Gross carrying amount	**2,922**	**345**	**389**	**72**	**3,728**
ECL allowance	**(1)**	**(11)**	**(96)**	**(11)**	**(119)**
Carrying amount	**2,921**	**334**	**293**	**61**	**3,609**

					2018*
	Stage 1	Stage 2	Stage 3	POCI	Total
Amortised cost	€ m	€ m	€ m	€ m	€ 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)
Carrying amount	3,193 -	410 -	379 -	66 -	4,048

Of the total loans to customers of € 3,728 million, € 2,887 million or 77% are rated as either ‘strong’ or ‘satisfactory’ which is an decrease of € 233 million (2018: € 3,120 million or 75%), and was evidenced across all segments. The ‘criticised’ classification includes ‘criticised watch’ of € 246 million and ‘criticised recovery’ of € 137 million, the total of which has decreased by € 116 million in the 12 months to 31 December 2019. Overall, the total performing book has decreased by € 349 million to € 3,270 million or 88% of gross loans and advances to customers (2018: € 3,619 million and 87%).

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk- Credit profile of the loan portfolio
Internal credit grade profile by ECL staging *(continued)*
Non-performing loans are aligned to the Bank's definition of default and Stage 3 credit impaired with the exception of those originating in POCI (€ 69 million). Non-performing loans originating in Stage 1 have remained at Nil in the year to 31 December 2019. Non-performing loans have reduced by € 100 million to € 458 million or 12% of gross loans and advances to customers (2018: € 558 million and 13%).

Non-performing exposures ('NPE') to customers
The table below further analyses non-performing loans and advances to customers by asset class at 31 December 2019 and 2018:

Non-performing loans	2019	2018
	Total	Total
Residential Mortgages		
	€m	€m
At amortised cost		
Collateral disposals	30	3
Unlikely to pay (including > 90 days past due)	371	469
Non-performing loans probation	57	86
Total gross carrying amount at amortised cost	458	558
Total non-performing loans and advances to customers	458	558
Total ECL on non-performing loans and advances to customers	107	116
Non-performing loans as % of total loans and advances to customers	12%	13%

Non-performing loans reduced by € 100 million or 18% to € 458 million in the 12 months to 31 December 2019. This reduction continues to be reflective of proactive deleveraging activities primarily due to loan portfolio sales and redemptions.

Income statement
There was a € 37 million net credit impairment charge in the 12 months to 31 December 2019, recoveries of € 7 million on loans previously written off.

Residential mortgage arrears
Total loans in arrears (including non-performing loans) by value decreased by 17% during the 12 months to 31 December 2019, a decrease of 17% in the owner-occupier portfolio and a decrease of 57% in the buy-to-let portfolio. The decrease in the buy-to-let arrears was driven by the portfolio sale of distressed loans.

Forbearance
Forbearance occurs when a borrower is granted a temporary or permanent concession or an agreed change to the existing contracted terms of a facility ('forbearance measure'), for reasons relating to the actual or apparent financial stress or distress of that borrower. This also includes a total or partial refinancing of existing debt due to the actual or apparent financial stress or distress of a borrower or where a borrower avails of an embedded forbearance clause(s). A forbearance agreement is entered into where the customer is in actual or apparent financial stress or distress to the extent that they are unable currently to repay both the principal and interest in accordance with the existing contracted terms of a facility. A concession or an agreed change to the contracted terms can be of a temporary (e.g. interest only) or permanent (e.g. term extension) nature.

The Bank uses a range of initiatives to support its customers. The Bank considers requests from customers who are experiencing cash flow difficulties on a case by case basis in line with the Bank's Forbearance Policy and relevant procedures, and completes an affordability / repayment capacity assessment taking account of factors such as current and likely future financial circumstances, the borrower's willingness to resolve such difficulties, and all relevant legal and regulatory obligations to ensure sustainable measures are put in place as appropriate.

The Bank's Credit Policies, supported by relevant processes and procedures, are in place which set out the policy rules and principles underpinning the Bank's approach to forbearance, ensuring the forbearance measure(s) provided to borrowers are affordable and sustainable, and in line with relevant regulatory requirements. Key principles include providing support to enable customers remain in their family home, whenever possible. The Bank has implemented the standards for the Codes of Conduct in relation to customers in actual or apparent financial stress or distress, as set out by the Central Bank of Ireland, ensuring these customers are dealt with in a professional and timely manner.

3.1 Credit risk

Forbearance *(continued)*

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 measure. This may result in the downgrading of the credit grade assigned and an increase in the expected credit loss. Facilities 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.

The effectiveness of 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 revised or original terms of the contract over a sustained period of time resulting in an improved outcome for the Bank and the borrower.

Irish residential mortgages subject to forbearance measures decreased by € 85 million from € 640 million at 31 December 2018 to € 555 million at 31 December 2019. A key feature of the forbearance portfolio is the level of advanced forbearance solutions driven by the Bank's strategy to deliver sustainable long-term solutions to customers and support customers in remaining in their family home.

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's finances;
– Assessment – Using the financial information to assess the customer's situation; and
– Resolution – We work with the customer to find an appropriate resolution.

The core objective of the process is to determine sustainable solutions that, where possible, help to keep customers in their family home. In addition to relevant short term measures, this includes the following long term forbearance measures which have been devised to assist existing Republic of Ireland primary residential mortgage customers in actual or apparent financial stress or distress: low fixed interest rate sustainable solution, split mortgages, negative equity trade down, voluntary sale for loss, arrears capitalisation and term extension.

Risk Management Report

3.1 Credit risk

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 residential mortgage portfolio by the indexed loan-to-value ratios and the weighted average loan-to-value ratios at 31 December 2019 and 2018:

	2019*														
	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%	1,173	1	1,174	92	—	92	143	1	144	10	—	10	1,418	2	1,420
50% to 70%	868	1	869	113	1	114	96	—	96	22	—	22	1,099	2	1,101
71% to 80%	330	2	332	44	—	44	40	—	40	11	—	11	425	2	427
81% to 90%	291	1	292	43	—	43	28	—	28	13	—	13	375	1	376
91% to 100%	219	—	219	39	—	39	34	—	34	9	—	9	301	—	301
101% to 120%	32	—	32	13	—	13	33	—	33	4	—	4	82	—	82
121% to 150%	3	—	3	—	—	—	11	—	11	—	—	—	14	—	14
Greater than 150%	1	—	1	—	—	—	3	—	3	—	—	—	4	—	4
Total with LTVs	2,917	5	2,922	344	1	345	388	1	389	69	—	69	3,718	7	3,725
Unsecured	—	—	—	—	—	—	—	—	—	2	1	3	2	1	3
Total	2,917	5	2,922	344	1	345	388	1	389	71	1	72	3,720	8	3,728

The weighted average indexed loan-to-value of the stock of residential mortgages at 31 December 2019 was 58% and Stage 3 residential mortgages was 65%.

* Forms an integral part of the audited financial statements

3.1 Credit risk

Loans and advances to customers – Residential mortgages *(continued)*

Actual and weighted average indexed loan to value ratios of Republic of Ireland residential mortgages *(continued)*

2018*

	At amortised cost														
	Stage 1			Stage 2			Stage 3			POCI			Overall total		
	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	Owner-occupier €m	Buy-to-let €m	Total €m	Owner-occupier €m	Buy-to-let €m	Total €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	21	—	21	1,143	4	1,147
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	4,163	10	4,173
Unsecured	—	—	—	—	—	—	—	—	—	4	—	4	4	—	4
Total	3,187	7	3,194	420	1	421	486	2	488	74	—	74	4,167	10	4,177

The weighted average indexed loan-to-value of the stock of residential mortgages at 31 December 2018 was 63% and Stage 3 residential mortgages was 84%.

* Forms an integral part of the audited financial statements

3.1 Credit risk - Credit profile of the loan portfolio - Asset class analysis

Residential mortgages – properties in possession

The Bank seeks to avoid repossession through working with customers, but where an agreement cannot be reached, the Bank proceeds with the repossession of the property or the appointment of a receiver. The Bank uses external agents to realise the maximum value as soon as it 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.

The number (stock) of properties in possession at 31 December 2019 and 2018 is set out below:

	2019		2018	
	Stock	**Balance outstanding € m**	Stock	Balance outstanding € m
Owner-occupier	**72**	**18**	162	42
Buy-to-let	**—**	**—**	1	—
Total	**72**	**18**	163	42

The stock of residential properties in possession decreased by 91 properties in 2019. This decrease relates to the disposal of 26 properties (31 December 2018: 13 properties) which were offset by the addition of 46 properties (31 December 2018: 9 properties), the majority of which were voluntary surrenders or abandonments. In addition, a further 136 properties were removed from the stock in 2019, mainly due to the sale of a portfolio of loans.

The disposal of 26 residential properties in the Republic of Ireland resulted in a total loss on disposal of €3 million at 31 December 2019 (before loss allowance) and compares to 31 December 2018 when 13 residential properties were disposed of resulting in a total loss of €2m. Losses on the sale of such properties are recognised in the income statement as part of the net credit impairment losses.

Residential mortgages – repossessions disposed of

The following table analyses the disposals of repossessed properties for the years ended 31 December 2019 and 2018:

					2019
	Number of disposals	**Outstanding balance at repossession date € m**	**Gross sales proceeds on € m**	**Costs to sell € m**	**Loss on sale(1) € m**
Owner-occupier	**26**	**6**	**3**	**—**	**3**
Buy-to-let	**—**	**—**	**—**	**—**	**—**
Total residential	**26**	**6**	**3**	**—**	**3**

					2018
	Number of disposals	Outstanding balance at repossession date € m	Gross sales proceeds on disposal € m	Costs to sell € m	Loss on sale(1) € m
Owner-occupier	13	3	2	1	2
Buy-to-let	—	—	—	—	—
Total residential	13	3	2	1	2

(1)Before ECL allowance

3.1 Credit risk - Credit profile of the loan portfolio - Asset class analysis

Gross loans movements and ECL movements[(1)]

The following table explains the changes in the gross carrying amount and ECL allowances for loans and advances to customers by ECL staging for the years to 31 December 2019 and 2018.

Amounts that triggered movements between Stage 1 and Stage 2 as a result of failing/curing a quantitative measure only (as disclosed on page 18) and that subsequently reverted within the period to their original stage, are excluded from 'Transferred from Stage 1 to Stage 2' and 'Transferred from Stage 2 to Stage 1'. The Bank believes this presentation aids the understanding of underlying credit migration.

Gross carrying amount movements

					2019*
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	€m	**€m**	**€m**	**€m**	**€m**
At 1 January	**3,194**	**421**	**488**	**74**	**4,177**
Transferred from Stage 1 to Stage 2	**(253)**	**253**	**—**	**—**	**—**
Transferred from Stage 2 to Stage 1	**331**	**(331)**	**—**	**—**	**—**
Transferred to Stage 3	**(3)**	**(51)**	**54**	**—**	**—**
Transferred from Stage 3	**4**	**67**	**(71)**	**—**	**—**
Redemptions/repayments	**(427)**	**(46)**	**(43)**	**(5)**	**(521)**
Interest credited	**87**	**13**	**10**	**3**	**113**
Write-offs	**—**	**—**	**(52)**	**(1)**	**(53)**
Other movements	**(11)**	**19**	**3**	**1**	**12**
At 31 December	**2,922**	**345**	**389**	**72**	**3,728**

					2018*
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	€m	**€m**	**€m**	**€m**	**€m**
At 1 January	3,242	750	674	74	4,740
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)
Interest applied to accounts	93	23	14	—	130
Other movements	208	(236)	6	—	(22)
At 31 December	3,194	421	488	74	4,177

(1)Movements on the gross loans table have been prepared on a 'sum of the months' basis

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk - Credit profile of the loan portfolio- Asset class analysis

Gross loans movements and ECL movements[1] ***(continued)***

ECL allowance movements

					2019*
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	€m	**€m**	**€m**	**€m**	**€m**
At 1 January	**1**	**11**	**109**	**8**	**129**
Transferred from Stage 1 to Stage 2	**—**	**8**	**—**	**—**	**8**
Transferred from Stage 2 to Stage 1	**—**	**(6)**	**—**	**—**	**(6)**
Transferred to Stage 3	**—**	**(2)**	**5**	**—**	**3**
Transferred from Stage 3	**—**	**1**	**(6)**	**—**	**(5)**
Net remeasurement	**(1)**	**(3)**	**6**	**2**	**4**
Impact of Model changes	**—**	**—**	**29**	**1**	**30**
Impact of credit or economic risk parameters	**1**	**2**	**6**	**1**	**10**
Income statement credit impairment charge	**—**	**—**	**40**	**4**	**44**
Write-offs	**—**	**—**	**(52)**	**(1)**	**(53)**
Other movements	**—**	**—**	**(1)**	**—**	**(1)**
At 31 December	**1**	**11**	**96**	**11**	**119**

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

Total exposures to which an ECL applies decreased during the year by € 449 million from € 4,177 million as at 1 January 2019 to € 3,728 million as at 31 December 2019.

Stage transfers are a key component of ECL allowance movements (i.e. Stage 1 to Stage 2 to Stage 3) being the primary driver of a higher income statement charge (and vice versa) in addition to the net remeasurement of ECL due to change in risk parameters within a stage.

Transfers from Stage 1 to Stage 2 of € 253 million represent the underlying credit activity where a significant increase in credit risk occurred at some point during the period through either the quantitative or qualitative criteria for stage movement. The main driver of the movements to Stage 2 was the doubling of PDs, subject to 50bps.

Similarly, transfers from Stage 2 to Stage 1 of € 331 million 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.

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk

Gross loans movements and ECL movements *(continued)*

In 2019, following an assessment of the mortgage exposures, a change to the quantitative SICR difference threshold from 50bps to 85bps was approved by the Bank. This was implemented to the Irish residential mortgage portfolio as at December 2019.

Transfers from Stage 2 to Stage 3 of € 51 million represent those loans that defaulted during the period. 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 € 67 million were mainly driven by resolution activity with the customer, through either restructuring or forbearance previously granted and which 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 € 4 million primarily reflect curing events from default where no forbearance measure was required.

Reduction due to write-offs continues to reflect utilisation of ECL stock as a result of restructure of customer debt in line with the Bank's strategy.

The contractual amount outstanding of loans written-off during the year that are subject to enforcement activity amounted to €30 million (2018: €123 million) which includes both full and partial write-offs. Total cumulative non-contracted loans written-off at 31 December 2019 amounted to €144 million (2018: €123 million).*

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

Stage 1 loans decreased by € 272 million in 2019 with an ECL of € 1 million and resulting cover of 0.04%. This was primarily due to redemptions / repayments.

Stage 2 loans decreased by € 76 million in 2019 with an ECL of € 11 million and resulting cover of 3.26%. This was primarily driven by loans for which a significant increase in credit risk no longer applied and/or which had completed a probation period.

Stage 3 loans decreased by € 99 million in 2019 with an ECL of € 96 million and resulting cover of 24.72%. Key drivers reflect loans completing default probation periods, write-offs and redemptions / repayments.

[1]Movements on the gross loans table have been prepared on a 'sum of the months' basis

* Forms an integral part of the audited financial statements

Risk Management Report

3.1 Credit risk - Credit quality of forborne loans and advances to customers*

The following table sets out the internal credit ratings and ECL staging of forborne loans and advances to customers at 31 December 2019 and 2018:

	2019 €m	2018 €m
Strong	—	—
Satisfactory	—	1
Total	—	1
Criticised Watch	—	—
Criticised Recovery	139	609
Total	139	609
Non-performing	383	1,360
Gross carrying amount	522	1,970
Analysed by ECL staging		
Stage 1	—	21
Stage 2	136	609
Stage 3	315	1,280
POCI	71	60
Total	522	1,970
Total gross carrying amount of loans and advances to customers	3,728	4,177

3.2 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 fall due, without incurring unacceptable costs or losses. Funding is the means by which liquidity is generated, e.g. secured or unsecured, wholesale, corporate or retail. In this respect, funding risk is the risk that a specific form of liquidity cannot be obtained at an acceptable cost.

The objective of liquidity management is to ensure that, at all times, the Bank 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 Group ("the Group") liquidity management. In accordance with the Capital Requirements Regulation ("CRR"), the Bank has appointed the Group 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 Group liquidity risk management process. This includes the risk identification and assessment, risk management and mitigation, risk monitoring and reporting processes. Under this centralised approach the management of liquidity and related activities for the Bank is integrated with the Group.

The means by which these liquidity management activities are performed, and the procedures by which the Group ensures the Bank complies with the Group Funding and Liquidity Risk Policy are managed through a Service Level Agreement ("SLA").

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

a. the issuance of Mortgage Covered Securities in accordance with the Asset Covered Securities Acts ("ACS Acts");
b. borrowing funds from AIB;
c. borrowing from the Central Bank under a Mortgage-Backed Promissory Note (short term) facility ("MBPN Facility") and other funding from the Central Bank under facilities which may be available to the Bank from time to time;
d. capital funding to ensure at a minimum compliance with the capital adequacy requirements of the Single Supervisory Mechanism ("SSM").

If utilised, the MBPN Facility would be secured by a floating charge over a pool of the Bank's home loans and related security which would be separate to the Pool (that secures the Mortgage Covered Securities) maintained by the Issuer in accordance with the ACS Acts.

* Forms an integral part of the audited financial statements

3.2 Funding and liquidity risk *(continued)*

The Bank's Management team monitors the funding and liquidity risks and reports to the Board on developments on a regular basis

Identification and assessment*

Funding and 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 both internal limits and 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 AIB 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. These metrics are key risk metrics for the Group and are monitored against AIB Board approved limits.

Management and measurement*

The Group operates a three lines of defence model for risk management. For funding and liquidity risk, the first line comprises of the Finance function who, reporting to the Group CFO, is responsible for providing the necessary information for the management of the Group liquidity gap and the efficient management of the liquidity buffer. This involves the identification, measurement and reporting of funding and liquidity risk and the application of behavioural adjustments to assets and liabilities.

This function is the owner of the Group's Funding and Liquidity Plan which sets out the strategy for funding and liquidity management for the Group and is responsible for the day to day management of liquidity to meet payment obligations, execution of wholesale funding requirements in line with the Group Funding and Liquidity Plan and the management of the foreign exchange funding gap.

First line management of funding and liquidity risk consists of:

– aims to ensure a balanced spread of repayment obligations through active management of the Group's liability maturity profile. Monitoring ratios also apply to longer periods for long term funding stability;
– 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
– monitors net inflows and outflows on a daily basis.

The second line of defence comprises of the Risk function who, reporting to the Group CRO, provides second line assurance over funding and liquidity management. This function provides oversight on the effectiveness of the risk and control environment. It proposes and maintains the ILAAP Framework and supporting policies as the basis of the bank'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). This function is also responsible for the integrity of the Group's liquidity risk methodologies.

The third line of defence comprises Group Internal Audit who provide third line assurance on funding and liquidity risk.

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

Monitoring, escalating and reporting

The Bank's funding and liquidity position is reported to the Board. In addition it is reported as part of the overall AIB Group position to AIB Group's Asset and Liability Committee ("ALCo"), the AIB Group Risk Committee ("GRC"), the AIB Board Risk Committee ("BRC"), the AIB Executive Committee ("ExCo") and the AIB Board.

Liquidity risk stress testing

Liquidity stress testing is a key component of the AIB Group ILAAP framework. The Bank, as part of the Group, undertakes liquidity stress testing that includes both firm specific and systemic risk events and a combination of both as a key liquidity control. Stressed assumptions are applied to the Group's liquidity buffer and liquidity risk drivers. The purpose of these tests is to ensure the continued stability of the Group liquidity position within pre-defined liquidity risk tolerance levels. Liquidity stress test results are reported to Group ALCo, AIB Executive Committee and AIB Board.

As part of its contingency and recovery planning the Group has identified a suite of potential funding and liquidity options which could be exercised to help the Group to restore its liquidity position on the occurrence of a major stress event.

* Forms an integral part of the audited financial statements

Risk Management Report

3.2 Funding and liquidity risk *(continued)*

Encumbrance

An asset is defined as encumbered if it has been pledged as collateral and as a result is no longer available to the Bank to secure funding, satisfy collateral needs or to be sold. The Group manages encumbrance levels to ensure that the Bank, as part of the Group, has sufficient contingent collateral to maximise balance sheet flexibility.

The Bank had an encumbrance ratio of 77% at 31 December 2019 (2018: 68%). The encumbrance level is based on the amount of assets that are required in order to meet regulatory and contractual commitments.

Financial liabilities by undiscounted contractual maturity*

The following tables analyses, on an undiscounted basis, financial liabilities by remaining contractual maturity at 31 December 2019 and 2018:

						2019
	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	**649**	**—**	**—**	**—**	**—**	**649**
Derivative financial instruments	**—**	**—**	**—**	**10**	**11**	**21**
Debt securities in issue	**—**	**—**	**500**	**1,515**	**517**	**2,532**
Other liabilities	**7**	**—**	**—**	**—**	**—**	**7**
Total	**656**	**—**	**500**	**1,525**	**528**	**3,209**

						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	—	—	—	11	12	23
Debt securities in issue	—	—	—	1,500	1,038	2,538
Other liabilities	3	—	—	—	—	3
Total	732	—	—	1,511	1,050	3,293

3.3 Capital adequacy risk*

Capital adequacy risk is the risk that the Bank does not maintain sufficient capital to achieve its business strategy, support our customers or to meet regulatory capital requirements. Capital adequacy risk for EBSMF is evaluated through the annual financial planning and AIB Group Internal Capital Adequacy Assessment Processes (ICAAP) where the level of capital required to support growth plans and meet regulatory requirements is assessed over the three year planning horizon. Plans are assessed across a range of scenarios ranging from base case and moderate downside scenarios to a severe but plausible stress using the Groups stress testing methodologies. The impact of changing regulatory requirements, changes in the risk profile of the Bank's balance sheet and other internal factors, and changing external risks are regularly assessed by first line of defence and second line of defence teams via regular monitoring of performance against the Financial Plan and Strategy. An annual material risk assessment is conducted to identify all relevant (current and anticipated) material risks which are then assessed from a capital perspective.

The EBSMF Board reviews and approves the EBSMF Financial Plan and the supporting stress tests on an annual basis, confirming it is satisfied with the capital adequacy of the Bank.

* Forms an integral part of the audited financial statements

3.4 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 d.a.c., 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 d.a.c. 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

3.4 Market risk *(continued)*

Interest Rate Exposure and Sensitivity*

The net interest rate exposure of the Bank at 31 December 2019 analysed by the earlier of the repricing and the contractual maturity date is illustrated in the following table:

	0≤1mth	1≤3mths	3≤12mths	1≤2yrs	2≤3yrs	3≤4yrs	4≤5yrs	5yrs+	Non-interest bearing	2019 Total
	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Assets										
Loans and advances to customers	2,795	51	219	269	99	179	116	—	(119)	3,609
Loans and advances to banks	58	—	—	—	—	—	—	—	—	58
Derivatives and other financial instruments	—	—	—	—	—	—	—	—	21	21
Other assets	—	—	—	—	—	—	—	—	5	5
Total Assets	2,853	51	219	269	99	179	116	—	(93)	3,693
Liabilities										
Deposits by banks	649	—	—	—	—	—	—	—	—	649
Derivatives and other financial instruments	—	—	—	—	—	—	—	—	21	21
Debt securities in issue	2,532	—	—	—	—	—	—	—	—	2,532
Other liabilities	—	—	—	—	—	—	—	—	10	10
Shareholders' equity	—	—	—	—	—	—	—	—	481	481
Total Liabilities	3,181	—	—	—	—	—	—	—	512	3,693
Derivatives affecting interest rate sensitivity	(932)	51	219	269	99	178	116	—	—	—
Interest sensitivity gap	604	—	—	—	—	1	—	—	(605)	—
Cumulative interest sensitivity gap	604	604	604	604	604	605	605	605	—	—

The impact on net interest income over a twelve month period of a 100 bps downward/upward movement in interest rates on 31 December 2019 would be circa -€1 million/€1 million respectively.

* Forms an integral part of the audited financial statements

Risk Management Report

3.4 Market risk *(continued)*

Interest Rate Exposure and Sensitivity* *(continued)*

										2018
	0≤1mth	1≤3mths	3≤12mths	1≤2yrs	2≤3yrs	3≤4yrs	4≤5yrs	5yrs+	Non-interest bearing	Total
	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m	€ m
Assets										
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 securities in issue	2,538	—	—	—	—	—	—	—	—	2,538
Other liabilities	—	—	—	—	—	—	—	—	7	7
Shareholders' equity	—	—	—	—	—	—	—	—	851	851
Total Liabilities	3,267	—	—	—	—	—	—	—	881	4,148
Derivatives affecting interest rate sensitivity	(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 bps downward/upward movement in interest rates on 31 December 2018 would be circa -€2 million /€2 million respectively.

* Forms an integral part of the audited financial statements

3.4 Market risk

Interest rate benchmark reform

Authorities and regulators have requested that the market transition from interbank offered rates referred to as “IBOR” benchmark rates (e.g. Euribor) to alternative Risk Free Rates (RFRs) by end 2021. The reform was not contemplated when IAS 39 was published, and consequently the IASB has published a set of temporary exceptions from applying specific hedge accounting requirements to provide clarification on how the relevant standards should be applied in these circumstances.

The application of this set of temporary exceptions is mandatory for accounting periods starting on or after 1 January 2020, but early adoption is permitted which the Bank elected to do at 31 December 2019.

Significant judgement will be required in determining when uncertainty is expected to be resolved and, therefore, when the temporary exceptions will cease to apply. However, at 31 December 2019, the uncertainty continued to exist and so the temporary exceptions apply to all of the Bank's hedge accounting relationships that reference benchmarks subject to reform or replacement.

The Bank has cash flow hedge accounting relationships that are exposed to different IBORs. The transition not only impacts financial markets, but also many of the Bank's customers who have an IBOR referenced in their contract. IBORs are extensively embedded within the Bank's processes, hence, this transformation will have far reaching impacts in terms of pricing, operations, risk, accounting, data and technology infrastructure, along with potential conduct risk implications.

AIB mobilised an Interest Rate Benchmark Reform Transition Programme ("The Programme") in 2018 to manage the successful evolution to, and embedding of, RFRs. The Programme is sponsored by the AIB Chief Financial Officer, overseen by a steering committee, chaired by a senior Treasury executive, supported by a Project Management layer and working groups comprising representation from customer-facing businesses, Finance, Treasury, Risk, Compliance, Legal, Operations and Customer and Strategic Affairs within AIB Group.

The programme is organised into four main workstreams, namely:

– Business readiness;
– Technology;
– Contract re-papering; and
– Customer communications and conduct.

The Programme is structured to deliver IBOR transition by the regulators’ deadline of 31 December 2021, with much of the recent action focused on business readiness activities, agreeing new fallback clauses and preparing for awareness amongst the Bank's customers. The Programme is also briefed on the activities associated with transitioning Euro OverNight Index Average (“EONIA”) to Euro short-term rate (“€STER”).

The Bank’s primary exposure to impacted benchmark rates is EURIBOR which has an amended calculation methodology and is now considered Benchmark Regulation compliant, thus reducing the impact of reform on the Bank.

3.5 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.

Risk and Control Assessment ("RCA") is a core process in the identification and assessment of operational risk across AIB, including EBS Group. 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 and compliance (GRC) system. SHIELD provides all areas with one consistent view of the risks, controls, actions and events across AIB. SHIELD underpins a robust risk culture focused on ensuring better customer outcomes while helping to safeguard, protect and support AIB. RCAs are regularly reviewed and updated by business unit management. A materiality matrix is in place to enable the scoring of risks, and action plans must be developed to provide mitigants for the more significant risks. Monitoring processes are in place at business unit and support level. The group operational risk team sets and maintains policies and procedures for self-assessment and undertakes risk based reviews and testing to ensure the completeness and robustness of each business unit's self-assessment, and that appropriate attention is given to the more significant risks

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 Service Agreement. AIB's operational risk framework applies across all areas of AIB including the Bank. 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, as well as the end-to-end mortgage origination and servicing processes.

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

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

3.6 Regulatory compliance risk

Regulatory compliance risk is defined as the risk of legal or regulatory sanctions or failure to protect market integrity that could result in material financial loss or reputational damage. Failure to comply with laws, regulations, or rules, for example Anti-Money Laundering and Countering Terrorist Financing, as well as self-regulatory standards and codes of conduct, could result in regulatory sanction.

The level of regulatory risk remained high in 2019 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 2019, projects were mobilised within AIB to prepare for the regulatory change horizon as outlined in AIB's annual report: Governance and Oversight – Supervision and Regulation.

The level of regulatory change is expected to remain at high levels in 2020 and beyond.

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.

3.7 Conduct risk

Conduct risk is defined as the risk that inappropriate actions or inactions by the Bank cause poor or unfair customer outcomes. Customer Complaints outstanding without proper investigation would lead to unfair customer outcomes.

AIB uses various approaches to help mitigate risks relating to conduct risk including a Conduct Risk Framework, aligned with AIB's strategy, which is embedded in the organisation and provides oversight of conduct risks at Executive Committee and Board level by way of two key fora. AIB Group Conduct Committee provides the Executive Committee oversight of conduct through promoting and supporting a 'customer first' culture, and also oversees the key conduct risk appetite metrics for complaints management and product reviews. AIB Group Product and Proposition Committee focus is exclusively in product oversight and management, including overseeing a rolling programme of product reviews.

The Bank's conduct risk is managed in line with the processes, procedures and organisational structures for the management of Conduct risk within AIB Group.

3.8 People and culture risk

People and culture risk is the risk to achieving the Bank'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 the Bank 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 the Bank. The majority of business activities of the Bank are outsourced to AIB under a Managed Service Agreement.

AIB uses various approaches to help mitigate risks relating to people and culture risk including a continuous review of the market situation and the introduction of new career mapping which will provide a transparent and consistent view of roles and also empower all employees to take accountability and control of their own careers.

AIB identifies and reviews employee satisfaction and engagement, indicators of culture, through the 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 the AIB's risk management activities by embedding the risk appetite statement in policies and frameworks of AIB. The risk appetite statement contains clear statements of intent as to AIB's appetite for taking and managing risk, including people a culture risk. It ensures that AIB monitors and reports against key people and culture metrics when tracking people & culture risk and change.

Internal Audit include people & culture risk on their annual plan of activities, the outputs of which are reviewed by the 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. This also includes the risk of implementing an unsuitable strategy, or maintaining an obsolete business model, in light of known internal and external factors.

The Bank identifies and assesses business model risk as part of its Financial Planning process, which encapsulates strategic, business and financial planning. Every year, the bank prepares three-year business plans based on macro-economic and market forecasts across a range of scenarios.

The Bank's Financial Plan is aligned to its strategy and risk appetite. The business plan typically describes external market conditions, competitor dynamics, business strategy, financial assumptions underpinning the strategy, actions/investment required to achieve financial outcomes and any risks/opportunities to the strategy.

The Bank manages business model risk via its Risk Appetite Statement, 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 regular monitoring of actual performance versus plan across a range of key performance indicators. 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 executive management and Board on a quarterly basis. Risk profile against risk appetite measures, some of which reference performance against plan, is monitored monthly by the AIB Group Risk Function, with breaches of Risk Appetite relating to EBSMF reported on a monthly basis to the AIB Group Risk Committee. The EBSMF Risk Appetite is also reported quarterly to EBSMF Executive Management and Board.

3.10 Model risk

Model risk is defined as the potential loss the Bank may incur, as a consequence of decisions that could be principally based on the output of models, due to errors in the development, implementation or use of such models.

The Board of EBS MF has ultimate accountability for ensuring that the models used by EBS MF are fit for purpose and meet all jurisdictional regulatory and accounting standards. Operating to the principles outlined in the Model Risk Framework (the Framework) supports EBS MF’s strategic objectives and provides comfort to the Board on the integrity and completeness of the model risk governance.

AIB mitigates model risk at a group level by having a model risk framework, policies and standards in place in relation to model development, operation, and validation together with suitable resources. The Framework, which is aligned to 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.

AIB Group Internal Audit act as the “third line of defence” providing independent assurance to the Board 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.

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

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

Directors' Responsibility Statement

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

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. 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 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: 25 March 2020

Deloitte.

Deloitte Ireland LLP
Chartered Accountants &
Statutory Audit Firm

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 "Company")

In our opinion, the Company financial statements:

- give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2019 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 31, 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 Company 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 Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Ireland, including the Ethical Standard issued by the Irish Auditing and Accounting Supervisory Authority ("IAASA"), as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Emphasis of matter – Financial statements prepared on a basis other than that of going concern

In forming our opinion on the financial statements, which is not modified, we have considered the adequacy of the disclosure made in note 1 to the financial statements, which explains that the financial statements have been prepared on a basis other than that of a going concern.

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Expected credit losses on loans and advances to customers; and • IT systems and controls. 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 to be € 9 million which is approximately 2% of total Shareholders Equity of the Company.
Significant changes in our approach	*Key audit matters* As part of our 2019 audit we have identified one new key audit matter: - IT systems and controls: We regard this area as a key audit matter owing to the high level of IT dependency within the Company, the associated complexity and the risk that automated controls are not designed and operating effectively.

Deloitte.

	Materiality For the current year, we have considered total Shareholders' Equity to be the critical component for determining materiality taking into consideration the nature of the Company's operations as being primarily for funding purposes.

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

In line with IFRS 9, losses on financial assets which are classified at amortised cost are recognised on an Expected Credit Loss ("ECL") basis. ECLs are required to incorporate forward looking information, reflecting Management's view of potential future economic environments. The complexity involved in the calculations require Management to develop methodologies involving the use of significant judgements.

Expected credit loss allowances on loans and advances to customers were € 119 million at 31 December 2019 (2018: € 129 million).

Measurement of the ECL allowance 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 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 portfolios 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 page 70 (Accounting Policy (1.12) – Impairment of financial assets), Note 2 – Critical accounting judgements and estimates, Note 9 – Net credit impairment charge and Note 14 – Loans and advances to customers.

How the scope of our audit responded to the key audit matter

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 macroeconomic 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 the definition of default 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.

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 at and observation of AIB Board Risk Committee and AIB Group Credit Committee meetings. We evaluated IT system controls including assessing data inputs and general IT controls. 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 Company. In conjunction with Deloitte credit modelling specialists, we challenged judgements and assumptions supporting the ECL requirements of IFRS 9. 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. We challenged the macroeconomic scenarios chosen and changes to the weightings applied. This included benchmarking the economic data used to recognised external data sources. We also considered the impact of key uncertainties, including Brexit as well as assumptions made by Management around a 'Global Slowdown' scenario. We considered material 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 and application. 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 adequacy of 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 the ECL allowance and the sensitivity of the allowance to changes in the underlying assumptions. Based on the evidence obtained, we found that the ECLs on loans and advances to customers are within a range we consider to be reasonable.

IT systems and controls

Key audit matter description	The Company's financial reporting processes are reliant on processes, controls and data managed by IT systems. The IT environment is complex and pervasive to the operations of the Company due to the large volume of transactions processed daily and the reliance on automated and IT dependent manual controls. This risk is also impacted by dependency on third parties and outsourced arrangements, as well as migration to new systems. Our planned audit approach relies extensively on IT applications and the operating effectiveness of the control environment. As part of our assessment of the IT environment, we considered privileged user access management controls to be critical in ensuring that only appropriately authorised changes are made to relevant IT systems. Moreover, appropriate access controls contribute to mitigating the risk of potential fraud or error as a result of changes to applications or processing unauthorised transactions. We regard this area as a key audit matter owing to the high level of IT dependency within the Company, as well as the associated complexity and the risk that automated controls are not designed and operating effectively.
How the scope of our audit responded to the key audit matter	We examined the design of the governance framework associated with the Company's IT architecture. We gained an understanding and tested relevant General IT Controls for systems we considered relevant to the financial reporting process, including access management, programme development and change management. We gained an understanding of relevant IT controls over applications, operating systems and databases that are relevant for the financial reporting process and tested their operating effectiveness. We assessed the relevant automated controls within business processes and the reliability of

Deloitte.

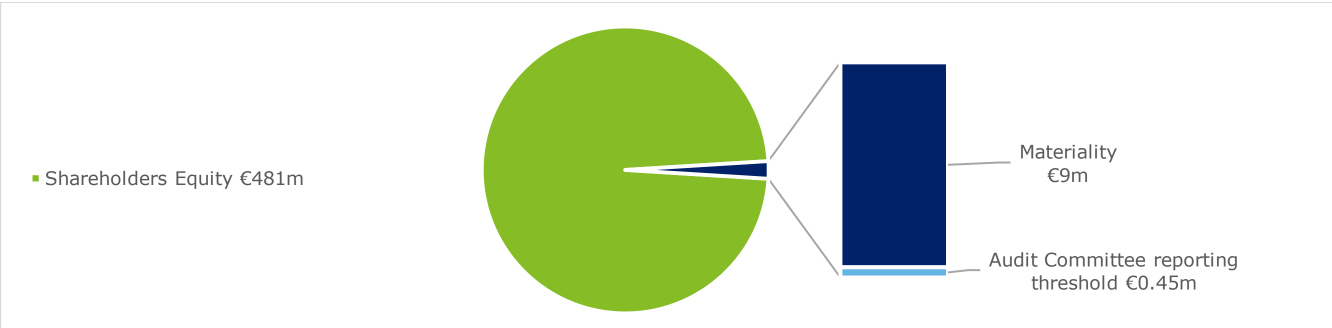
	relevant reports used as part of manual controls. This included assessing the integrity of system interfaces, the completeness and accuracy of data feeds and automated calculations. We tested user access by assessing the controls in place for in-scope applications and verifying the addition and removal of users. While we identified certain design and operating effectiveness deficiencies in relation to user access controls, we tested validation activities performed by Management and compensating controls to mitigate the risk of fraud or error as a result of unauthorised transactions. Based on this testing we were able to place reliance on IT controls for the purpose of our audit.

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

Our application of materiality

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

We determined materiality for the Company to be € 9m which is approximately 2% of Shareholders' Equity. In the prior year, we determined materiality with reference to an adjusted Profit Before Tax ("PBT"). For the current year, we have considered total Shareholders' Equity to be the critical component for determining materiality. We used this benchmark taking into consideration the nature of the Company's operations as being primarily for funding purposes. We have considered quantitative and qualitative factors such as understanding the entity and its environment, history of misstatements, complexity of the Company and the reliability of the control environment.



We agreed with the Board that we would report to them any audit differences in excess of €0.45 million, 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 Company and its environment, including the controls operating within the Company, and assessing the risks of material misstatement related to the financial statements of the Company. The risks of material misstatement that had the greatest effect on our audit are identified as key audit matters in the table above.

Other information

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

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

We have nothing to report in this regard.

Deloitte.

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 Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

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

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

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

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

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

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

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

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.

This report is made solely to the Company's members, as a body, in accordance with Section 391 of the Companies Act 2014. Our audit work has been undertaken so that we might state to the Company's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law,

Deloitte.

we do not accept or assume responsibility to anyone other than the Company and the Company's members as a body, for our audit work, for this report, or for the opinions we have formed.

Report on other legal and regulatory requirements

Opinion on other matters prescribed by the Companies Act 2014

Based solely on the work undertaken in the course of the audit, we report that:

- We have obtained all the information and explanations which we consider necessary for the purposes of our audit.
- In our opinion the accounting records of the Company were sufficient to permit the financial statements to be readily and properly audited.
- The Statement of Financial Position is in agreement with the accounting records.
- In our opinion the information given in the Directors' Report is consistent with the financial statements and the Directors' Report has been prepared in accordance with the Companies Act 2014.

Corporate Governance Statement

We report, in relation to information given in the Corporate Governance Statement on pages 3 to 4 that:

- In our opinion, 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 company'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 company 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 Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Directors' Report.

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

Other matters which we are required to address

Following the recommendation of the Board 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 7 years, covering the years ending 2013 to 2019.

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

Our audit opinion is consistent with the additional report to the 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: 27 March 2020

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 2019

	Note	**2019** **€ m**	2018 € m
Interest income calculated using the effective interest method	3	**112**	133
Interest and similar expense	4	**(6)**	(11)
Net interest income		**106**	122
Net trading income	5	**2**	2
Net gain on other financial assets measured at FVTPL	6	**1**	1
Total operating income		**109**	125
Administrative expenses	7	**(38)**	(71)
Operating profit before impairment charge and taxation		**71**	54
Net credit impairment charge	9	**(37)**	(9)
Operating profit before taxation from continuing operations		**34**	45
Income tax charge	10	**(4)**	(6)
Profit for the year		**30**	39

The operating profit arises from continuing operations.

Statement of Comprehensive Income

For the financial year ended 31 December 2019

	2019 **€ m**	2018 € m
Profit/(loss) for the year	**30**	39
Other comprehensive income for the year	**—**	—
Total comprehensive income for the year	**30**	39

The notes on pages 62 to 91 are an integral part of these financial statements.

Statement of Financial Position

As at 31 December 2019

	Note	2019 € m	2018 € m
Assets			
Non-current assets held for sale	11	**5**	2
Derivative financial instruments	12	**21**	23
Loans and advances to banks	13	**58**	75
Loans and advances to customers	14	**3,609**	4,048
Total assets		**3,693**	4,148
Liabilities			
Deposits by banks	16	**649**	729
Derivative financial instruments	12	**21**	23
Debt securities in issue	17	**2,532**	2,538
Other liabilities	18	**1**	—
Deferred taxation	15	**3**	4
Accruals and deferred income	19	**6**	3
Total liabilities		**3,212**	3,297
Shareholders' equity			
Issued share capital presented as equity	21	**138**	552
Revenue reserves		**343**	299
Shareholders' equity		**481**	851
Total liabilities and shareholders' equity		**3,693**	4,148

The notes on pages 62 to 91 are an integral part of these financial statements.

Helen Dooley
Chair

Chris Curley
Managing Director

Date: 25 March 2020

Diane Lumsden
Company Secretary

Gerry Gaffney
Executive Director

Date: 6 March 2023

Statement of Cash Flows

For the financial year ended 31 December 2019

	Note	2019 € m	2018 € m
Cash flows from operating activities			
Operating profit for the year before taxation		**34**	45
Adjustments for:			
Net credit impairment charge	9	**37**	9
Depreciation, amortisation and impairment		**—**	—
Investment income		**—**	—
(Gain)/loss on disposal of investment securities		**—**	—
Amounts written off investment securities		**—**	—
Change in provisions for liabilities and commitments	20	**—**	(1)
		71	53
Changes in operating assets and liabilities			
Change in deposits by central banks and banks	16	**(80)**	(994)
Change in loans and advances to customers	14	**404**	438
Change in loans and advances to banks	13	**—**	(5)
Change in accruals and deferred income	19	**3**	3
Change in derivative financial instruments		**—**	—
Change in non-current assets held for sale		**(3)**	—
Change in other liabilities		**(1)**	2
Net cash flows from operating assets and liabilities		**323**	(556)
Net cash flows from operations before taxation		**394**	(503)
Taxation (paid)/refund		**(5)**	(7)
Net cash flows from operations		**389**	(510)
Cash flows from investing activities			
Net cash flows from investing activities		**—**	—
Cash flows from financing activities			
Debt securities issued		**—**	516
Debt securities redeemed		**(6)**	—
Capital Reduction		**(400)**	
Net cash flows from financing activities		**(406)**	516
Change in cash and cash equivalents		**(17)**	6
Opening cash and cash equivalents		**75**	69
Closing cash and cash equivalents	23	**58**	75

The notes on pages 62 to 91 are an integral part of these financial statements.

Statement of Changes in Shareholders' Equity

For the financial year ended 31 December 2019

	Ordinary Share Capital € m	Revenue Reserves € m	Total Shareholders' Equity € m
At 1 January 2019	**552**	**299**	**851**
Total comprehensive income for the financial year			
Profit for the financial year	**—**	**30**	**30**
Other comprehensive income	**—**	**—**	**—**
Capital reduction[1]	**(414)**	**414**	**—**
Capital repayment[1]	**—**	**(400)**	**(400)**
At 31 December 2019	**138**	**343**	**481**

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			
Profit for the financial year	—	39	39
Other comprehensive income	—	—	—
At 31 December 2018	552	299	851

[1]For details in relation to the capital reduction transaction see note 21. Issued share capital presented as equity.

Notes to the financial statements

Accounting policies index	61
1. Accounting policies	62
2. Critical accounting judgements and estimates	74
3. Interest income calculated using the effective interest method	76
4. Interest expense and similar charges	76
5. Net trading income	76
6. Net gain on other financial assets measured at FVTPL	76
7. Administrative expenses	76
8. Auditor's fees	77
9. Net credit impairment charge	78
10. Taxation	78
11. Non-current assets held for sale	78
12. Derivative financial instruments	79
13. Loans and advances to banks	79
14. Loans and advances to customers	80
15. Deferred taxation	80
16. Deposits by banks	81
17. Debt securities In issue	81
18. Other liabilities	83
19. Accruals and deferred income	83
20. Provisions for liabilities and commitments	83
21. Issued share capital presented as equity	84
22. Capital management	84
23. Statement of cash flows	85
24. Segmental information	85
25. Commitments	85
26. Classification and measurement	86
27. Fair value of financial instruments	87
28. Related party transactions	90
29. Non-adjusting events after reporting period	91
30. Parent company	91
31. Approval of financial statements	91

Notes to the financial statements

Accounting policies index

1.1	Reporting entity
1.2	Statement of compliance
1.3	Basis of preparation
1.4	Interest income and expense recognition
1.5	Net trading income
1.6	Income tax, including deferred tax
1.7	Financial assets
1.8	Financial liabilities
1.9	Determination of fair value of financial instruments
1.10	Derivatives and hedge accounting
1.11	Derecognition
1.12	Impairment of financial assets
1.13	Non-current assets held for sale
1.14	Non-credit risk provisions
1.15	Shareholders' equity
1.16	Cash and cash equivalents
1.17	Prospective accounting changes

Notes to the financial statements

1. ACCOUNTING POLICIES

The accounting policies applied in the preparation of the financial statements for the financial year ended 31 December 2019 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 adopted by the European Union ("EU") and applicable for the financial year ended 31 December 2019. The financial statements also comply with the Companies Act 2014 applicable to companies reporting under IFRS and the European Communities (Credit Institutions: Financial Statements) Regulations, 2015, and the Asset Covered Securities Acts 2001 and 2007. The accounting policies have been consistently applied by the Bank and are consistent with the previous year, unless otherwise described.

1.3. Basis of preparation

Functional and presentation currency

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

Basis of measurement

The financial statements have been prepared under the historical cost basis, with the exception of the following assets and liabilities which are stated at their fair value: derivative financial instruments and 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 section of the annual financial statements. The relevant information on those pages is identified as forming an integral part of the audited financial statements.

While the directors' intention is to wind up the entity no actions have been taken to commence this process. On that basis the measurement and recognition under IFRS is unchanged under the basis other than going concern.

Use of estimates and judgements

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

A description of these judgements and estimates is set out in Note 2: 'Critical accounting judgements and estimates'.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.3. Basis of preparation *(continued)*

Going concern

The financial statements for the financial year ended 31 December 2019 have been prepared on a basis other than that of going concern as the Directors intend to complete a transfer of the business of the Bank to its' sole shareholder. The Directors do not believe that the Bank will continue in existence for the foreseeable future.

As noted under the basis of measurement no change to measurement and recognition under IFRS is required as a result of the preparation on a basis other than going concern.

First time adoption of new accounting standard/amendments to standards

The following new standard and amendments to standards have been adopted by the Bank during the year ended 31 December 2019.

IFRS 16 *Leases*

The effective date for IFRS 16 *Leases* was 1 January 2019 and was adopted by the Bank on that date. The new standard replaces IAS 17 *Leases*.

IFRS 16 had an insignificant impact on these financial statements during the year to 31 December 2019.

Interest Rate Benchmark Reform

Amendments to IFRS 9 *Financial Instruments*; Amendments to IAS 39 *Financial Instruments: Recognition and Measurement*; and Amendments to IFRS 7 *Financial Instruments: Disclosures.*

In September 2019, the IASB amended some of its requirements for hedge accounting in order to support the provision of useful financial information by companies during the period of uncertainty arising from the phasing out of interest-rate benchmarks such as interbank offered rates (IBORs) and their replacement with alternative nearly risk-free interest rates. These amendments allow hedging relationships affected by the IBOR reform to be accounted for as continuing hedges.

The Bank has early adopted these amendments for the financial year to 31 December 2019. The Bank will continue to apply the amendments to IFRS 9 and IAS 39 until the uncertainty arising from interest rate benchmark reform with respect to the timing and amount of underlying cash flows ends. The Bank has assumed that this uncertainty will not end until the Bank's contracts that reference IBORs are amended or fallback clauses are added to existing contracts.

For further details of Interest Rate Benchmark Reform see page 45.

***Definition of Material* (Amendments to IAS 1 and IAS 8)**

The amendments to IAS 1 *Presentation of Financial Statements* and IAS 8 *Accounting Policy, Changes in Accounting Estimates and Errors which* were issued in October 2018 and effective for reporting periods beginning on or after 1 January 2020 with earlier application permitted, clarify the definition of material 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”.

The amendments are aimed at improving the understanding of the existing requirements rather than to significantly impact current materiality judgements. The new definition of material is to be used to assess whether information, either individually or in combination with other information, is material in the context of the financial statements.

The amendments are not expected to significantly impact on the Bank's interpretation of material.

The Bank early adopted these amendments with effect from 1 January 2019.

Other amendments resulting from improvements to IFRSs which the Bank adopted in 2019 did not have any impact on the accounting policies, financial position or performance of the Bank.

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.

1. ACCOUNTING POLICIES

1.4. Interest income and expense recognition *(continued)*

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.

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 investment debt securities measured at FVOCI calculated on an effective interest basis;
- Interest on financial assets measured at FVTPL;
- Net interest income and expense on qualifying hedge derivatives designated as cash flow hedges or fair value hedges which are recognised in interest income or interest expense; and
- Interest income and funding costs of trading portfolio financial assets.

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. 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 financial year using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous financial years.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.6. Income tax, including deferred tax *(continued)*

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

The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.
Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle the current tax assets and liabilities on a net basis or to realise the asset and settle the liability simultaneously.

1.7. 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.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.7. Financial assets *(continued)*

- 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.

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 measurement 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.

1.8. 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.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.8. Financial liabilities *(continued)*

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.

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.

1.9. 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.

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.

1. ACCOUNTING POLICIES

1.9. Determination of fair value of financial instruments *(continued)*

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

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

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

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

The 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.

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

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

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

Hedging

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.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.10. Derivatives and hedge accounting *(continued)*

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’).

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

The Bank discontinues hedge accounting when:

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

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

Fair value hedge accounting

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

Derivatives 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.

1.11. Derecognition

Financial assets

The Bank derecognises a financial asset when the contractual rights to the cash flows from the financial asset expire or it transfers the rights to receive the contractual cash flows in a transaction in which substantially all of the risks and rewards of ownership of the financial asset are transferred or in which the Bank neither transfers nor retains substantially all of the risks and rewards of ownership and it does not retain control of the financial asset.

On derecognition of a financial asset, the difference between the carrying amount of the asset and the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised in OCI is recognised in profit or loss. Relevant costs incurred with the disposal of a financial asset are deducted in computing the gain or loss on disposal.

Any cumulative gain/loss recognised in OCI in respect of equity investment securities designated as at FVOCI is not recognised in profit or loss on derecognition of such securities. However, the amount held in investment securities reserves is transferred to revenue reserves on derecognition. Any interest in transferred financial assets that qualify for derecognition that is created or retained by the Group is recognised as a separate asset or liability.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.11. Derecognition *(continued)*

The Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them. In such cases, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

In transactions in which the Bank neither retains nor transfers substantially all of the risks and rewards of ownership of a financial asset and it retains control over the asset, the Bank continues to recognise the asset to the extent of its continuing involvement, determined by the extent to which it is exposed to changes in the value of the transferred asset.

In certain transactions, the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract if the servicing fee is more than adequate or is less than adequate for performing the servicing.

The write-off of a financial asset constitutes a derecognition event. Where a financial asset is partially written-off, and the portion written-off comprises specifically identified cash flows, this will constitute a derecognition event for that part written-off.

1.12. 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’).

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.

1. ACCOUNTING POLICIES

1.12. Impairment of financial assets *(continued)*

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.

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.

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.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.12. Impairment of financial assets *(continued)*

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.

Once a financial asset is written-off either partially or fully, the amount written-off cannot subsequently be recognised on the balance sheet. It is only when cash is received in relation to the amount written-off that income is recognised in the income statement as a 'recovery of bad debt previously written-off'.

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

1.13. Non-current assets held for sale

A non-current 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, non-current 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. However, financial assets within the scope of IFRS 9 continue to be measured in accordance with that standard.

Impairment losses subsequent to classification of assets as held for sale are recognised in the income statement. Subsequent increases in fair value less costs to sell 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 non-current 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.

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

Legal claims and other contingencies

Provisions are made for legal claims where the Bank has present legal or constructive obligations as a result of past events and it is more likely than not that an outflow of resources will be required to settle the obligation and the amount can be reliably estimated.

Contingent liabilities are possible obligations whose existence will be confirmed only by the occurrence of uncertain future events or present obligations where the transfer of economic benefit is uncertain or cannot be reliably estimated. Contingent liabilities are not recognised but are disclosed in the notes to the financial statements unless the possibility of the transfer of economic benefit is remote.

A provision is recognised for a constructive obligation where a past event has led to an obligating event. This obligating event has left the Bank with little realistic alternative but to settle the obligation and the Bank has created a valid expectation in other parties that it will discharge the obligation.

1.15. Shareholders' 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.

Notes to the financial statements

1. ACCOUNTING POLICIES

1.15. Shareholders' equity *(continued)*

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

Share issue costs
Incremental costs directly attributable to the issue of new shares are charged, net of tax, to equity.

Dividends and distributions
Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's 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. They also include amounts arising from the capital reduction undertaken by the Bank in June 2019.

1.16. Cash and cash equivalents

For the purposes of the cash flow statements, cash comprises cash on hand and 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.

1.17. Prospective accounting changes

There are no new standards and amendments to existing standards which have been approved by the IASB, but not early adopted by the Bank, that will impact the Bank's financial reporting in future periods.

Notes to 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.

Significant judgements

The significant judgements made by the Bank in applying its accounting policies are set out below. The application of these judgements also necessarily involves estimations, which are discussed separately.

– Impairment of financial assets; and
– Provisions for liabilities and commitments.

Impairment of financial assets

The Bank's accounting policy for impairment of financial assets is set out in accounting policy 1.12 in note 1. The expected credit loss ('ECL') allowance for financial assets at 31 December 2019 represent management's best estimate of the expected credit losses on various portfolios at the reporting date.

The calculation of the ECL allowance is complex and therefore, an entity must consider large amounts of information in their determination. This process requires significant use of a number of accounting judgements, estimates and assumptions, some of which, by their nature, are highly subjective and very sensitive to risk factors such as changes to economic conditions. Changes in the ECL allowance can materially affect net income.

The most significant judgements applied by the Bank in estimating the ECL allowance are as follows:

– *determining the criteria for a significant increase in credit risk and for being classified as credit impaired;*
– *definition of default;*
– *choosing the appropriate models and assumptions for measuring ECL, e.g. PD, LGD and EAD and the parameters to be included within the models;*
– *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 uncertainty;*
– *determining post-model adjustments using an appropriate methodology; and*
– *assessing the impact of forbearance strategies on cash flows and therefore, the ECL allowance for restructured loans.*

The management process for the calculation of the ECL allowance is underpinned by independent tiers of review. The Bank assesses and approves the ECL allowance and its adequacy on a quarterly basis. The ECL allowance is, in turn, reviewed and approved by the AIB Group Credit Committee on a quarterly basis with final AIB Group levels being approved by the AIB Board Audit Committee. Further detail on the ECL governance process is set out on page 26.

Credit quality and ECL provisioning are independently monitored by credit and risk management on a regular basis. On an ongoing 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.

The significant accounting judgements noted above and made by Management in estimating the ECL allowance are outlined on pages 24 and 25 in the Risk management section of this report.

Provisions for liabilities and commitments

The Bank's accounting policy for provisions for liabilities and commitments is set out in note 1.14 Non-credit risk provisions.

The Bank recognises liabilities 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 liabilities and commitments are shown in note 20. Provisions for liabilities and commitments to the financial statements.

Significant management judgement is involved in this process which, of its nature, may require revisions to earlier judgements and estimates as matters progress towards resolution, particularly, in establishing provisions and the range of reasonably possible losses.

Notes to the financial statements

2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

Provisions for liabilities and commitments *(continued)*
The recognition and measurement of liabilities, in certain instances, may involve a high degree of uncertainty, and thereby, considerable time is expended on research in establishing the facts, scenario testing, assessing the probability of the outflow of resources and estimating the amount of any loss. 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.

The judgements employed in estimating potential losses will change over time and the actual losses may vary significantly.

Critical accounting estimates
The accounting estimates with a significant risk of material adjustment to the carrying amounts of assets and liabilities within the next financial year were in relation to:
– ECL allowance

ECL allowance
ECL allowances at 31 December 2019 amounted to €119 million (2018: €129 million). As noted above, there are significant judgements involved in estimating ECL allowance. Certain of these estimates together with estimates which do not involve accounting judgements may have a significant risk of material adjustment to carrying amounts of assets within the next financial year.

The macroeconomic variables used in models to calculate ECL allowance are based on assumptions, forecasts and estimates. These are subject to change as the economic landscape changes. Accordingly, changes in local and international factors could have a material bearing on the ECL allowance within the next financial year. The Bank's sensitivity to a range of macroeconomic factors under (i) base forecast; (ii) upside; and (iii) downside scenarios is set out on pages 23 to 24 of the Risk Management section of this report.

Notes to the financial statements

3. INTEREST INCOME CALCULATED USING THE EFFECTIVE INTEREST METHOD

	2019	2018
	€m	€m
Interest on loans and advances to customers at amortised cost	112	129
Interest earned from AIB	—	4
	112	133

All interest income is calculated using the effective interest method.

4. INTEREST AND SIMILAR EXPENSE

	2019	2018
	€m	€m
Interest payable to AIB	6	11
	6	11

5. NET TRADING INCOME

	2019	2018
	€m	€m
Debt securities and interest rate contracts	2	2
	2	2

There was a net trading gain of €2m (2018: €2m) to reflect a movement in the mark to market valuation of swap hedging instruments.

6. NET GAIN ON OTHER FINANCIAL ASSETS MEASURED AT FVTPL

	2019	2018
	€m	€m
Loans and advances to customers	1	1
	1	1

The fair value gain on loans and advances to customers measured at FVTPL was €1m in 2019 (2018: €1m).

7. ADMINISTRATIVE EXPENSES

	2019	2018
	€m	€m
Amounts payable to EBS	34	57
Other administrative expenses	4	14
	38	71

Amounts payable to EBS decreased to €34m in 2019 from €57m in 2018 following the revision of the transfer pricing calculation for 2019. The reduction in the Return on Equity Transfer Pricing service charge is compensated by lower interest income as the loan book declines and an increase in ECL write-offs.

Other administrative expenses consists of statutory payments (regulatory payments/levies) €3.9m (2018: €3.8m), professional fees €0.1m (2018: €0.4m) and a charge in relation to provisions for liabilities and commitments of Nil which related to customer redress and other costs (2018: charge of €10.1m). See note 20.Provisions for liabilities and commitments for further information on provisions.

There were no full time equivalents employed by the Bank in the financial year 2019 (2018: Nil), monthly average Nil.

7. ADMINISTRATIVE EXPENSES *(continued)*

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 Managed Service 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.

Non-Executive Directors' remuneration

	2019	2018
	€ 000	€ 000
Fees	**21**	35
	21	35

	2019	2018
	€ 000	€ 000
Denis Holland	**—**	11
William Cunningham	**—**	4
Brendan McDonagh	**10**	10
Jim O'Hara	**11**	10

No additional remuneration has been made to any individuals employed directly by AIB for roles discharged as directors of the Bank. The non-Executive Directors' 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 were no amounts paid (2018: Nil) to persons connected with a director in accordance with Section 306(1) of the Companies Act 2014.

8. AUDITOR'S FEES

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

	2019	2018
	€ 000	€ 000
Auditor's fees *(excluding VAT)*:		
Statutory Audit of entity financial statements	**20**	13
Other assurance services	**—**	—
Tax advisory services	**—**	—
Other non-audit services	**—**	—
	20	13

Notes to the financial statements

9. NET CREDIT IMPAIRMENT CHARGE

Net credit impairment charge on financial instruments	2019 Measured at amortised cost €m	2019 Total €m	2018 Measured at amortised cost €m	2018 Total €m
Net measurement of loss allowance				
Loans and advances to customers	(44)	(44)	(13)	(13)
Credit impairment charge	(44)	(44)	(13)	(13)
Recoveries of amounts previously written off	7	7	4	4
Net credit impairment charge	(37)	(37)	(9)	(9)

10. TAXATION

	2019 €m	2018 €m
Current taxation		
Current tax on income for the financial year	(5)	(6)
Deferred taxation		
Amortisation of DTL created on IFRS 9 Transition	1	—
Total tax charge for the financial year	(4)	(6)
Effective income tax rate	12.5%	12.5%

Factors affecting the effective tax rate
The following table sets out the difference between the tax charge that would result from applying the standard corporation tax rate in Ireland of 12.5% and the actual tax charge for the year:

	2019 € m	2019 %	2018 € m	2018 %
Operating profit before taxation	34		45	
Corporation tax charge	(4)	12.5%	(6)	12.5%
Tax Charge	(4)	12.5%	(6)	12.5%

11. NON-CURRENT ASSETS HELD FOR SALE

	2019 €m	2018 €m
Repossessed assets	5	2
	5	2

Repossessed assets are expected to be disposed of within one year.

Notes to the financial statements

12. 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 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.

	2019			2018		
	Contract/ Notional Amount	**Fair Values**		Contract/ Notional Amount	Fair Values	
		Assets	**Liabilities**		Assets	Liabilities
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Derivatives classified as trading						
Interest rate swaps	**3,964**	**21**	**(21)**	4,404	23	(23)
Total derivatives	**3,964**	**21**	**(21)**	4,404	23	(23)

The following table analyses the notional principal amount of interest rate derivative contracts by residual maturity together with the positive fair value attaching to these contracts where relevant:

				2019				2018
	Less than 1 year	**1 to 5 years**	**5 years +**	**Total**	Less than 1 year	1 to 5 years	5 years +	Total
Residual maturity	**€ m**	**€ m**	**€ m**	**€ m**	€ m	€ m	€ m	€ m
Notional principal amount	**—**	**839**	**3,125**	**3,964**	—	637	3,767	4,404
Positive fair value		**10**	**11**	**21**		11	12	23

13. LOANS AND ADVANCES TO BANKS

	2019	2018
	€ m	€ m
Funds placed with banks (third parties)	**12**	17
Funds placed with parent company	**46**	58
	58	75
Analysed by remaining maturity:		
3 months or less	**58**	*75*

The funds placed with 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 2019, the Bank's credit rating with Moody's was Aaa. At 31 December 2019, BNP bank credit rating with Standard & Poor's was A+, KBC bank credit rating was A+.

Notes to the financial statements

14. LOANS AND ADVANCES TO CUSTOMERS

	2019 € m	2018 € m
Analysed by remaining maturity:		
Repayable on demand	**231**	293
3 months or less	**2**	—
1 year or less but over 3 months	**4**	3
5 years or less but over 1 year	**91**	87
Greater than 5 years	**3,400**	3,794
	3,728	4,177
Expected credit loss allowance	**(119)**	(129)
	3,609	4,048

The following table shows the movements on the impairment loss allowance on financial assets as at 31 December 2019 and 2018:

	2019 € m	2018 € m
Opening Balance	**129**	290
Transition to IFRS 9	**—**	(45)
Net remeasurement of loss allowance - customers	**44**	13
Changes in loss allowance due to write-offs	**(53)**	(129)
Other movements	**(1)**	—
At 31 December	**119**	129
Amounts include loss allowance on:		
Loans and advances to customers measured at amortised cost	**119**	129

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 lending conditions.

15. DEFERRED TAXATION

	2019 €m	2018 €m
Deferred tax assets		
Total gross deferred tax assets	**—**	—
Deferred tax liabilities:		
Transition to IFRS 9	**3**	4
Total gross deferred tax liabilities	**3**	4
Net deferred tax liabilities	**3**	4

Notes to the financial statements

15. DEFERRED TAXATION *(continued)*
Analysis of movements in deferred taxation

	2019 €m	2018 €m
Opening balance	**4**	—
Transition to IFRS 9	**—**	6
At 1 January	**4**	6
Other adjustments	**—**	(2)
Income statement	**(1)**	—
At 31 December	**3**	4

Deferred tax liability is expected to be utilised within 3 years.

16. DEPOSITS BY BANKS

	2019 €m	2018 €m
Due to Parent company	**649**	729
	649	729

The facility limit with EBS is €4.0bn and the balance at 31 December 2019 amounted to €649m (2018: €729m). 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.

Borrowings from EBS are lower at 31 December 2019 by €80m due to a reduction in the Bank's net funding requirement, driven by lower customer loan balances €439m and 2019 profit after tax €30m, partially offset by capital distribution of €400m in 2019.

17. DEBT SECURITIES IN ISSUE

	2019 € m	2018 € m
Mortgage covered securities internal issuances at carrying value:		
EBS	**2,532**	2,538
	2,532	2,538
Analysed by remaining maturity		
Repayable on Demand	**—**	—
3 months or less	**—**	—
1 year or less but over 3 months	**500**	—
5 years or less but over 1 year	**1,515**	1,500
Greater than 5 years	**517**	1,038
Carrying value of debt securities	**2,532**	2,538

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 2019, the Cover Assets Pool amounted to €3.28bn (2018: €3.37bn), comprising of €3.27bn (2018: €3.36bn) of mortgage credit assets (mortgage loan accounts) and €0.01bn (2018: €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.

17. DEBT SECURITIES IN ISSUE *(continued)*
(a) Mortgaged properties and principal loan balances outstanding in the Cover Assets Pool

Total Loan Balances

From	To	Total Loan Balances 2019 (1 & 2) € m	Number of Mortgaged Properties 2019	Total Loan Balances 2018 (1 & 2) € m	Number of Mortgaged Properties 2018
€0	€100,000	**485**	**10,040**	478	10,013
€100,000	€200,000	**1,502**	**10,141**	1,508	10,144
€200,000	€500,000	**1,228**	**4,818**	1,309	5,119
Over €500,000		**55**	**82**	61	94
		3,270	**25,081**	3,356	25,370

(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 31,730 loan accounts (2018: 31,799) secured on 25,081 properties (2018: 25,370).

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

Geographical Area	Number of Mortgaged Properties 2019		Number of Mortgaged Properties 2018	
Co. Dublin	**8,835**	**35%**	**8,983**	**35%**
Outside Co. Dublin	**16,246**	**65%**	**16,387**	**65%**
	25,081	**100%**	**25,370**	**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 2019, there were 70 mortgage loan accounts (2018: 77) in default in the Cover Assets Pool (in default being defined as impaired mortgage loan accounts).

(d) Mortgage loan accounts in default in the cover assets pool with arrears greater than €1,000
During the financial year ended 31 December 2019, 1,130 mortgage loan account (2018: 1,151) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2019, there were 337 accounts in default in the Cover Assets Pool (2018: 277).

(e) Replacement of non-performing mortgage loan accounts from the cover assets pool
During the financial year ended 31 December 2019, 105 non-performing mortgage loan accounts (2018: 147) were removed in total from the Cover Assets Pool (For this purpose, non-performing is defined as credit grade 7 and 8, i.e. has the same meaning as in default). These loan accounts were not replaced with other assets as the Cover Assets Pool continued to meet all regulatory requirements.

(f) Amount of interest in arrears on mortgage loan accounts in the cover assets pool not written off
The total amount in arrears (including principal and interest) in respect of 900 accounts (2018: 724) as at 31 December 2019 was €0.4m (2018: €0.4m).

(g) Total principal and interest payments on mortgage loan accounts
The total amount of repayments (principal and interest) made by customers on mortgage loan accounts in the Cover Assets Pool during the year ended 31 December 2019 was €460m (2018: €479m), of which €366m (2018: €375m) represented repayment of principal and €94m (2018: €104m) represented payment of interest. The repayments of principal include the repayment of mortgage loan accounts by customers closing their existing accounts when opening a new account.

(h) Number and amount of mortgage loans in the cover assets pool secured on commercial property
As at 31 December 2019 there were no loan accounts (2018: Nil) in the Cover Assets Pool that were secured on commercial properties.

18. OTHER LIABILITIES

	2019	2018
	€ m	€ m
Sundry creditors	1	—
	1	—

19. ACCRUALS AND DEFERRED INCOME

	2019	2018
	€ m	€ m
Interest payable on mortgage covered securities	3	—
Other accrued expense	3	3
	6	3

20. PROVISIONS FOR LIABILITIES AND COMMITMENTS

	2019	2018
	€m	€m
At 1 January	—	1
Amounts charged to income statement	—	10
Provisions utilised	—	(11)
At 31 December	—	—

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). In 2018, an additional €10m was charged to income statement which was fully utilised within the year. The provision for customer redress and compensation remained at Nil at 31 December 2019 due to no further provision required in 2019 based on the current circumstance.

In 2015, the Bank also created a provision of €14m with regard to 'Other costs' which was fully utilised at 31 December 2018. The provision regarding 'Other Costs' remained at Nil at 31 December 2019.

Legal proceedings
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 d.a.c. acted with a lack of transparency, unfairly or without due skill and care. The investigations are ongoing and EBS d.a.c. are co-operating with the CBI.

The Bank has not created a provision for any administrative sanction as it understands that any such charge is expected to be borne by the Banks' parent. In this regard, EBS d.a.c. created a provision of €15m for the impact of potential monetary penalties that is expected to be imposed on EBS d.a.c. by the CBI being its best estimate at this time.

Litigation has been served on the Bank / EBS d.a.c. by customers that are pursuing claims in relation to tracker mortgages. Customers have also lodged complaints to the Financial Services and Pensions Ombudsman ("FSPO") in relation to mortgages issues.

Further claims may also be served in the future in relation to tracker mortgages. The Bank / EBS d.a.c. will also receive decisions by the FSPO in relation to complaints concerning mortgages.

Based on the facts currently known and the current stages that the litigation and the FSPO's complaints process are at, it is not practicable at this time to predict the final outcome of this litigation/FSPO complaints, nor the timing and possible impact on the Bank.

21. ISSUED SHARE CAPITAL PRESENTED AS EQUITY

	2019		2018	
	Number of shares		Number of shares	
	m	**€m**	m	€m
Authorised:				
Ordinary share capital				
Ordinary shares of €0.25 each	**1,000**	**250**	—	—
Ordinary shares of €1.00 each	**—**	**—**	1,000	1,000
Issued and fully paid up:				
Ordinary share capital				
Ordinary shares of €0.25 each	**552**	**138**	—	—
Ordinary shares of €1.00 each	**—**	**—**	552	552

	2019	2018
Movements in Issued share capital	**€ m**	€ m
At 1 January	**552**	552
Capital reduction	**(414)**	—
At 31 December	**138**	552

Capital Reduction
In 2019, at the request of EBS, the Bank's Board considered and approved an application to the ECB for authorization to implement a capital reduction and distribution of surplus capital to EBS.

Following receipt of ECB approval, the Bank's Board recommended the capital reduction and distribution to the shareholder, which was subsequently approved by EBS.

The approved capital reduction and capital repayment involved:
a) a reduction in the par value of each of the 552m issued shares from €1 to €0.25, reducing issued share capital by €414m;
b) a transfer of the reduction amount of €414m to revenue reserves; and
c) a capital repayment of €400m to EBS, resulting in a residual amount of €14m in revenue reserves.

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.

22. CAPITAL MANAGEMENT
Capital regulation
The Capital Requirements Directive IV "CRD IV"), which came into force on 1 January 2014, 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 main exception to this relates to the transitional arrangements for mitigating the impact of the introduction of IFRS 9 on capital as per Regulation (EU) 2017/2395 of the European Parliament and of the Council. 15% of the IFRS 9 impact on own funds (Equity, Tier 1 and 2) is reflected in 2019 (2018: 5%), with the impact on capital increasing each year (30% in 2020, 50% in 2021 and 75% in 2022) with full impact recognised in 2023.

Notes to the financial statements

22. CAPITAL MANAGEMENT *(continued)*
The Bank commenced reporting to its regulator under the transitional CRD IV rules during 2014. The transitional capital ratios presented on page 6 take account of these phasing arrangements. The fully loaded capital ratios represent the full implementation of CRD IV.

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

23. STATEMENT OF CASH FLOWS

Analysis of cash and cash equivalents

	2019	2018
	€m	€m
Loans and advances to banks (note 13)	**58**	75
	58	75

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

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

25. COMMITMENTS
At 31 December 2019 the Bank had €9m (2018: €9m) of approved mortgage loan applications that had not been drawn down as at the year end.

Loan commitments are classified and measured in accordance with IFRS 9. The Bank's accounting policy for the recognition of ECL allowances on loan commitments is set out in accounting policy number 1.12 Impairment of financial assets.

There was no ECL allowance recognised on loan commitments at 31 December 2019.

Notes to the financial statements

26. CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Financial assets and financial liabilities are measured on an ongoing basis as set out in note 1.3 on basis of preparation. The accounting policy for financial assets in note 1.7 and financial liabilities in note 1.8, describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised.

The following table analyses at 31 December 2019 and 2018 the carrying amounts of the financial assets and financial liabilities by measurement category as defined in IFRS 9 *Financial Instruments* and by statement of financial position heading.

	At fair value through profit or loss	At amortised cost		2019 Total
	Mandatorily	Loans and advances	Other	
	€m	€m	€m	€m
Financial assets				
Derivative financial instruments	**21**	**—**	**—**	**21**
Loans and advances to banks	**—**	**58**	**—**	**58**
Loans and advances to customers	**—**	**3,609**	**—**	**3,609**
	21	**3,667**	**—**	**3,688**
Financial liabilities				
Deposits by banks	**—**	**—**	**649**	**649**
Derivative financial instruments	**21**	**—**	**—**	**21**
Debt securities in issue	**—**	**—**	**2,532**	**2,532**
Other financial liabilities	**—**	**—**	**7**	**7**
	21	**—**	**3,188**	**3,209**

	At fair value through profit or loss	At amortised cost		2018 Total
	Mandatorily	Loans and advances	Other	
	€m	€m	€m	€m
Financial assets				
Derivative financial instruments	23	—	—	23
Loans and advances to banks	—	75	—	75
Loans and advances to customers	—	4,048	—	4,048
	23	4,123	—	4,146
Financial liabilities				
Deposits by banks	—	—	729	729
Derivative financial instruments	23	—	—	23
Debt securities in issue	—	—	2,538	2,538
Other financial liabilities	—	—	3	3
	23	—	3,270	3,293

27. FAIR VALUE OF FINANCIAL INSTRUMENTS

The term 'financial instruments' includes both financial assets and financial liabilities. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The Banks' accounting policy for the determination of fair value of financial instruments is set out in accounting policy number 1.9.

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.

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 such as shareholders' equity. These items are material and accordingly, the fair value information presented does not purport to represent, nor should it be construed to represent, the underlying value of the Bank as at 31 December 2019.

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

Financial instruments measured at fair value in the financial statements

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

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

Loans and advances to banks
The fair value of loans and advances to banks is estimated using discounted cash flows applying either market rates, where practicably 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, primarily using discounted cash flows and applying market rates where practicable. For EBS MF the fair value approximates the carrying value for customer loans as a result of the "Origination and Transfer Agreement" with EBS dated 28 November 2008.

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.

Notes to the financial statements

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

Debt securities in issue

The estimated fair value of subordinated liabilities and other capital instruments, and debt securities in issue, is based on quoted prices were 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. The debt securities in issue are held within the Group. The fair value of debt securities approximates to the book value as a result of the "Origination and Transfer Agreement" with EBS dated 28 November 2008.

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 hierarchy at 31 December 2019.

The following tables sets out the carrying value of financial instruments across the three levels of the fair value hierarchy at the 31 December 2019 and 2018:

					2019
	Carrying amount	Fair value			
		Fair value hierarchy			
		Level 1	Level 2	Level 3	Total
	€m	€m	€m	€m	€m
Financial assets measured at fair value					
Derivative financial instruments:					
Interest rate swaps	21	—	21	—	21
Financial assets not measured at fair value					
Loans and advances to banks	58	—	—	58	58
Loans and advances to customers	3,609	—	—	3,609	3,609
	3,667	—	—	3,667	3,667
Financial liabilities measured at fair value					
Interest rate swaps	21	—	21	—	21
Financial liabilities not measured at fair value					
Deposits by banks	649	—	—	649	649
Debt securities in issue	2,532		2,532	—	2,532
Other financial liabilities	7	—	—	7	7
	3,188	—	2,532	656	3,188

Notes to the financial statements

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

					2018
	Carrying amount	Fair value			
		Fair value hierarchy			
		Level 1	Level 2	Level 3	Total
	€m	€m	€m	€m	€m
Financial assets measured at fair value					
Interest rate swaps	23	—	23	—	23
Financial assets not measured at fair value					
Loans and advances to banks	75	—	—	75	75
Loans and advances to customers	4,048	—	—	4,065	4,065
	4,123	—	—	4,140	4,140
Financial liabilities measured at fair value					
Interest rate swaps	23	—	23	—	23
Financial liabilities not measured at fair value					
Deposits by banks	729	—	—	729	729
Debt securities in issue	2,538		1,975	—	1,975
Other financial liabilities	3	—	—	3	3
	3,270	—	1,975	732	2,707

Significant transfers between Level 1 and Level 2 of the fair value hierarchy
There were no transfers between Level 1 and Level 2 of the fair value hierarchy for the years ended 31 December 2019 and 2018.

28. RELATED PARTY TRANSACTIONS

The Bank is a wholly owned subsidiary of EBS d.a.c. ('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.

At 31 December 2019, there were no derivative transactions between the Bank and AIB.

The only related party transactions are normal banking transfers to and from EBS.

a) Transactions with EBS

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

	2019	2018
	€m	€m
Included in the statement of financial position		
Loans and advances to banks	**46**	58
Deposits by banks	**649**	729
Debt securities in issue	**2,532**	2,538
Derivative financial instruments		
Interest rate swaps		
Assets (Fair value)	**21**	23
Liabilities (Fair value)	**(21)**	(23)
Included in the income statement		
Interest income	**—**	4
Interest expense	**(6)**	(11)
Administrative expenses	**(34)**	(57)
Net trading income	**2**	2

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

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

(b) 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 ("KMP") are defined as comprising Executive, Non-Executive Directors and Senior Executive Officers including individuals employed by AIB p.l.c.. As at 31 December 2019 the Bank has 8 KMP (2018: 8 KMP).

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

Compensation of KMP, 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 Managed Service Agreement.

	2019	2018
	€'000	€'000
Short-term compensation*	**21**	35
Post-employment benefits	**—**	—
Termination benefits	**—**	—
	21	35

*Non-Executive Directors: comprises Directors' fees and travel and subsistence expenses incurred in the performance of the duties of their office, which are paid by AIB.

The figures shown include the figures separately reported in respect of Directors' remuneration in note 7. Administrative expenses

28. RELATED PARTY TRANSACTIONS *(continued)*

(b) IAS 24 Related Party Disclosures (continued)

(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 5 Directors in office during the year, none of whom availed of credit facilities (2018: 7).

(ii) Connected persons

The aggregate of loans to connected persons of Directors, in office during the year, at 31 December 2019, as defined in Section 220 of the Companies Act 2014, are as follows (aggregate of 1 person; 2018: 1):

	Balance at 31 December 2019	Balance at 31 December 2018
	€ 000	€ 000
Loans	**135**	141
Interest Charged during the year	**1**	2
Maximum debit balance during the year*	**141**	148

*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 2019 All facilities are performing to their terms and conditions

(d) Summary of 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.

Equity Interest in the ultimate parent of the Bank

At 31 December 2019, the State held 71.12% of the ordinary shares of AIB Group plc (31 December 2018: 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.

29. EVENTS AFTER REPORTING PERIOD

Coronavirus outbreak

The recent coronavirus outbreak (COVID-19) which is an emerging and potentially significant risk that the Bank and AIB are monitoring closely. The outbreak is expected to impact the economies or markets to which the Bank or our customers are exposed, and is likely to impact on the Bank's performance. AIB has established a monitoring group to assess the range of possible impacts, recognising emerging Irish Government supports and regulatory guidance and will continue to respond to the situation as it evolves. Any impact will depend on future developments, which are highly uncertain.

30. PARENT COMPANY

The Bank is a wholly owned subsidiary of EBS. EBS is a wholly owned subsidiary of AIB which is a wholly owned subsidiary of AIB Group plc. 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.aib.ie/investorrelations

31. APPROVAL OF FINANCIAL STATEMENTS

The financial statements were approved by the Board of Directors on 25 March 2020.