AIB Mortgage Bank

Directors' Report & Financial Statements

Year ended 31 December 2012

AIB Mortgage Bank

AIB Mortgage Bank

Directors' report and financial statements

Contents **Page**

Directors' and other information

Directors	Dave Keenan, Group Non-Executive Director and Chairman Jim O'Keeffe, Executive Director (Managing) Ivor Larkin, Executive Director James Murphy, Group Non-Executive Director Catherine Woods, Independent Non-Executive Director
Registered office	Bankcentre Ballsbridge Dublin 4 Ireland
Secretary	David Schorman
Registered Auditor	KPMG Chartered Accountants 1 Harbourmaster Place International Financial Services Centre Dublin 1 Ireland
Solicitor	Helen Dooley Group General Counsel Allied Irish Banks, p.l.c. Bankcentre Ballsbridge Dublin 4 Ireland
Banker	Allied Irish Banks, p.l.c.
Cover-Assets Monitor	Mazars Harcourt Centre Block 3 Harcourt Road Dublin 2 Ireland

Directors' Report

The Directors present their annual report and financial statements for the year ended 31 December 2012. A statement of Directors' responsibilities in relation to the financial statements appears on page 11.

Principal activities

AIB Mortgage Bank ('the Bank 'or 'AIBMB'), a public unlimited company, obtained an Irish banking licence under the Irish Central Bank Act, 1971 (as amended) and was registered as a designated mortgage credit institution under the Asset Covered Securities Act, 2001 on 8 February 2006. The Bank is a wholly owned subsidiary of Allied Irish Banks, p.l.c., ('AIB' or the 'AIB Group') and is regulated by the Central Bank of Ireland. Its principal purpose 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'). Such mortgage loans may be made directly by the Bank or may be purchased from AIB and other subsidiary undertakings of AIB Group or third parties.

The Bank commenced trading on 13 February 2006, when AIB Group transferred its Republic of Ireland branch originated residential mortgage business, amounting to €13.6bn in mortgage loans, to AIB Mortgage Bank. On 24 February 2006, a Mortgage-Backed Promissory Note facility between AIB Mortgage Bank and the Central Bank and Financial Services Authority of Ireland was put in place. In March 2006, the Bank launched a €15bn Mortgage Covered Securities Programme (the 'Programme') and has launched a number of covered bond issues since that date. The Programme was subsequently increased in 2009 to €20bn.

On 25 February 2011, AIB transferred substantially all of its mortgage intermediary originated Irish residential loans, related security and related business (the 'Intermediary Business') to AIB Mortgage Bank. The aggregate principal amount outstanding of and accrued but unpaid interest on, the Irish residential loans transferred by AIB to AIB Mortgage Bank on 25 February 2011 was approximately €4.2 billion. The transfer was effected pursuant to the statutory transfer mechanism provided for in the Asset Covered Securities Acts and was accounted for under IFRS 3 Business Combinations as a common control transaction at carrying value.

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.

The Bank's activities are financed through the issuance of mortgage covered securities and a Mortgage-Backed Promissory Note facility with the Central Bank of Ireland, with the balance of funding being provided by AIB Group.

Most of the Bank's activities are outsourced to AIB under an Outsourcing and Agency Agreement. AIB, as Service Agent for the Bank, originates residential mortgage loans through its retail branch network and the intermediary channels in the Republic of Ireland, services the mortgage loans, provides treasury services in connection with financing as well as a range of other support services.

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

Governance is exercised through a Board of Directors and a senior management team. The conditions of the Bank's Central Bank licence require that there should be a minimum of two Non-Executive Directors who are independent of the parent company and that the office of Managing Director should be filled on an ongoing basis.

Directors' Report

Principal activities *(continued)*
During 2012, there was only one independent Non-Executive Director on the Board of the Bank. In addition, the position of Managing Director was vacant until the appointment of Mr. Jim O'Keeffe on 28 February 2012.

During 2012, the Board also included five Executive Directors, all of whom were directly involved in the operation of AIB Mortgage Bank, and one other director, who while also an employee of AIB, was deemed to be a Non-Executive Director by virtue of the role he fulfilled in an area of the AIB Group unrelated to the operations of AIB Mortgage Bank.

Business review
The economic environment in Ireland continues to be very challenging for the residential mortgage business. Unemployment remained at elevated levels of 14.6% at end December 2012 compared to 14.8% at end December 2011. (Source: Central Statistics Office).

The fall from peak (February 2007) in house prices according to the CSO Residential Property Price Index was 49% at December 2012 (the fall in Dublin is 55% with properties outside Dublin falling by 47%).

The Bank is currently one of the few financial institutions offering competitive home loans in the Irish market. Our main focus is to offer viable owner-occupier mortgages and to support existing customers who wish to move home or top up their mortgage.

Total market mortgage drawdowns in Ireland were €2.6bn in 2012 compared with €2.5bn in 2011. The Bank's mortgage drawdowns were higher at €1.2bn in 2012 compared with €0.7bn in 2011. The Bank's mortgage portfolio before provisions decreased by 1% during 2012 to €23.8bn as at 31 December 2011 principally because repayments exceeded loans granted during the year (2011: increase of 17% to €24.0bn as at 31 December 2011 primarily due to the transfer of the Intermediary Business of €4.2bn in February 2011).

At 31 December 2012, the AIB Mortgage Bank's mortgage portfolio (comprising substantially all branch and intermediary originated loans) accounted for €23.8bn out of the total of AIB Group's residential mortgages, including EBS, of €42.6bn.

The AIB Mortgage Bank's portfolio comprises €17.1bn owner occupier (2011: €16.9bn) and €6.8bn buy to let mortgages (2011: €7.1bn). Of the owner occupier portfolio, 50% are ECB tracker, 37% are on variable interest rates and 13% are fixed. 6% of the owner occupier portfolio is on interest only repayments. Of the buy to let portfolio, 62% are ECB tracker, 35% are on variable interest rates and 3% are fixed. 24% of the buy to let portfolio are on interest only repayments.

As a result of the increased pressure on borrowers repayment capacity and further decreases in property prices, impaired loans have increased to €4.6bn, or 19.2% of total loans (2011: €2.7bn or 11.2%). Provisions made for impaired loans in 2012 also increased to €2,008m from €1,557m in 2011.

Forbearance Strategies
The Bank considers requests from customers who are experiencing cash flow difficulties on a case by case basis against their current and likely future financial circumstances, their willingness to resolve these difficulties, taking into account legal and regulatory obligations.

The Bank has implemented the Codes of Conduct in relation to customers in difficulty as set out by the Central Bank of Ireland ensuring these customers are dealt with in a professional and timely manner.

A forbearance agreement is entered into where the customer is in financial difficulty to the extent they are unable to repay both the principal and interest on their mortgage in accordance with the original contract terms. Modifications to the original contract can be of a temporary (e.g. interest only) or permanent (e.g. term extension) nature which is reviewed in conjunction with customers once the modified terms and conditions have expired.

Directors' Report

Forbearance Strategies *(continued)*
All forborne loans and those loans which have completed their period of forbearance and have returned to original terms and conditions are managed and monitored in line with the relevant credit approval and review authorities framework

The Bank has developed a Mortgage Arrears Resolution Strategy ("MARS") for dealing with mortgage customers in difficulty or likely to be in difficulty. This builds on and formalises the Bank's Mortgage Arrears Resolution Process, under which short term mortgage forbearance solutions (e.g. interest only; part capital and interest repayment; moratorium; capitalisation of arrears; term extension and deferred interest schemes) have been provided to customers in financial difficulty for the last number of years.

The strategy is built on three key factors: i) Segmentation – identifying customers in difficulty; ii) Sustainability – customer assessment; and iii) Suitable Treatment – identifying solutions. The core objectives are to ensure that arrears solutions are sustainable in the long term and they comply with the spirit and the letter of all regulatory requirements. MARS includes the following new longer-term forbearance solutions which have been devised to assist existing Republic of Ireland primary residential mortgage customers in difficulty:

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

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

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

These new long term forbearance options were introduced in 2012 and are now available to customers who meet the appropriate criteria.

Results for the year
The loss before taxation for 2012 was €339m, compared to a loss before taxation of €911m in 2011. The reduced loss is due mainly to a decrease in the provisions for impaired loan charge for the year.

Net interest income increased to €214m due to an increase in variable customer rates during the second half year and lower funding rates during the year leading to an improvement in the net interest margin to 0.90% in 2012 from 0.61% in 2011.

Interest income on mortgage loans reduced to €577m (2011: €622m), due to c. 0.3% lower average ECB Refi rate when compared to 2011. A similar reduction in interest income on funds placed with AIB plc €117m (2011: €152m), was offset by reduced interest payable on mortgage portfolio swaps, Euribor based funding €341m (2011: €436m), and interest on debt securities due to the lower average volume of securities in issue.

Administrative expenses increased by €20 million to €63 million during the year, primarily due to higher charges payable to AIB associated with the provision of outsourced services under the terms of the Mortgage Servicing Agreement.

The provision charge for impaired loans in 2012 was €494m, down from €1,034m in 2011. The provisions stock as at 31 December 2012 amounted to €2,008m (31 December 2011: €1,557m) of which €1,774m (31 December 2011: €953m) were specific and €234m (31 December 2011: €604m) were Incurred But Not Reported ("IBNR") provisions.

The increase in the specific provision was driven by the increase in the value of impaired loans (from €2,737m at end 2011 to €4,561m at end 2012) and increases in loss rates applied.

Directors' Report

Results for the year *(continued)*
The release of the IBNR provision was due to the conversion of the IBNR into specific provisions, particularly for mortgages in forbearance. A significant element of these had been provided in IBNR provisions at 31 December 2011 based on management's view of the risk inherent in the portfolio at that time as evidenced by the level of arrears, requests for forbearance and vulnerable loans in the portfolio. Management reassessed the IBNR requirement at 31 December 2012 in light of the increase in impaired loans and significant reduction in loans in forbearance which are not impaired resulting in a year end IBNR of €234m (2011: €604m).

Funding activities
The market backdrop improved over the course of 2012, particularly in the second half of the year, supported by the low interest rate environment and concerted European Central Bank action to ensure the provision of ample, long dated liquidity to the Euro zone area, via the introduction of three year Long Term Refinancing Operations. The ECB announcement in August of the introduction of Outright Monetary Transactions (OMTs) to enable the ECB intervene in secondary government bond markets proved supportive of credit markets.

Irish sovereign bond yields fell markedly, eight year yields dropping from circa 8% at the beginning of the year approximately 4% at year end. This facilitated a return to the sovereign debt markets by the National Treasury Management Agency, who conducted two bond exchange programmes, issued conventional and amortising bonds, and resumed auctions of short dated Treasury Bills. Covered bond markets across Europe performed strongly in 2012, as investors were faced with reduced supply.

The improvement in sentiment towards Ireland contributed to an improvement in the secondary trading levels of existing Irish covered bonds and increased appetite among investors for new issuance. In November, AIB Mortgage Bank returned to the primary market with one issuance of a new three year covered bond, the first public deal from the issuer since June 2007. The bond priced at mid-swaps plus 270 basis points, to yield 3.212%. The order book consisted of 170 orders from 20 countries, with 95% of the demand originating outside of Ireland. The bond traded strongly following issue, yielding approximately 2.46% at year end with a spread of 190 basis points over the swap curve.

In addition to resuming issuance in the primary markets, AIBMB continued to avail of the various liquidity facilities provided by the ECB. Under normal ECB open market operations, Covered Bonds, including Irish Covered Bonds with appropriate ratings are accepted as collateral for sale and repurchase agreements, thus providing liquidity. AIB Mortgage Bank and Allied Irish Banks, p.l.c. used internally issued Covered Bonds as a source of such liquidity throughout the year.

At 31 December 2012, total covered bonds in issue amounted to €10.3bn (31 December 2011: €12.4bn), of which €3.3bn (31 December 2011: €2.8bn) was issued to external debt investors, €1bn (31 December 2011: €3.2bn) was issued to Allied Irish Banks, p.l.c. and €6.02bn (31 December 2011: €6.4bn) was issued to AIB Mortgage Bank. Of the €7.02bn bonds issued to Allied Irish Banks, p.l.c. and to AIB Mortgage Bank at 31 December 2012, €7bn was held by the Central Bank of Ireland under sale and repurchase agreements.

The ratings as at 4 February 2013, for the Bank's Covered Bond Programme, AIB Group, and Ireland are shown below:

Rating Agency	AIB Mortgage Bank Covered Bond Programme	Allied Irish Banks p.l.c Issuer default rating	Ireland (Sovereign)
Fitch	A	BBB	BBB+
Moody's	Baa3	Ba2	Ba1
Standard & Poor's	A	BB	BBB+

Directors' Report

Risks and uncertainties
Information concerning the principal risks and uncertainties facing the Bank as required under the terms of the European Accounts Modernisation Directive (2003/51/EEC) is set out in the Risk Management Report.
AIB Mortgage Bank is reliant on AIB Group for a) financing and b) the operation of a number of outsourced activities leading to significant reliance on the AIB Group.
In summary, the AIB Group and as a result AIB Mortgage Bank considers the following risks and uncertainties to be the most material to its future performance:

- The Group's access to funding and liquidity is impacted by the financial instability within the Eurozone. Economic, monetary and political conditions, although improved, remain unstable within a number of Eurozone members.
- Contagion risks could disrupt the markets and adversely affect the Group's financial condition. Contagion risks in the markets in which the Group operates and dislocations caused by the interdependency of financial market participants is an on-going material risk to the Group's financial condition.
- Constraints on liquidiy, and market reaction to factors affecting Ireland and the Irish economy, have created an exceptionally challenging environment for the management of the Group's liquidity.
- General economic conditions continue to be very challenging for our mortgage and other lending to customers and increase the risk of payment default. The Group remains heavily exposed to the Irish residential property market. The high level of unemployment, coupled with a general reduction in disposable income (including increased taxes and pay reductions) has had an adverse impact on borrowers' ability to repay loans which is evidenced by the increasing arrears on residential property mortgages.
- The depressed Irish property prices may give rise to increased losses for the Group.
- The Group faces market risks, including non-trading interest rate risk.
- The Group is subject to rigourous and demanding Government supervision and oversight.
- The Group may be subject to the risk of having insufficient capital to meet increased minimum regulatory requirements.
- The Group's business activities must comply with increasing levels of regulation introduced as a result of failings in financial markets.
- The Group may be adversely affected by further austerity and budget measures introduced by the Irish Government.
- The Group's deferred tax assets depend substantially on the generation of future profits over an extended number of years.
- The Group is subject to inherent credit risks in respect of customers and counterparties which could adversely affect the Group's results, financial condition and future prospects.
- The Group faces heightened operational and reputational risks.
- The restructuring of the Group entails risks.

Share capital
The share capital of the Bank is €1,545m (2011: €1,345m), comprised of ordinary shares of €1 each. €200m of €1 ordinary shares were issued during 2012. (Note 16). In addition, the Bank received a capital contribution of €580m from its parent Allied Irish Bank's p.l.c. in 2011.

Directors' Report

Capital resources and regulatory capital ratios
The table below shows the components of the AIB Mortgage Bank's Tier 1 and total capital ratios as at 31 December 2012 and 31 December 2011.

	31 December 2012 €m	31 December 2011 € m
Tier 1		
Paid up ordinary share capital	**1,545**	1,345
Capital contribution	**580**	580
Eligible reserves	**(1,201)**	(904)
Total tier 1 capital	**924**	1,021
Tier 2		
Subordinated perpetual loan capital	**200**	200
Subordinated term loan capital	**100**	100
Standardised IBNR and Excess IRB provisions	**82**	80
Total tier 2 capital	**382**	380
Total capital	**1,306**	1,401
Risk weighted assets		
On balance sheet	**13,092**	12,078
Off-balance sheet	**38**	38
Total risk weighted assets	**13,130**	12,116
Capital ratios		
Tier 1	**7.04%**	8.20%
Total	**9.95%**	11.25%

Outlook
The capital position of the Bank is stable but the operating environment is expected to remain difficult for the foreseeable future.

Directors' Report

Books of account

The measures taken by the Directors to secure compliance with the Bank's obligation to keep proper books of account are the use of appropriate systems and procedures and the employment of competent persons. The books of account of the Bank are kept at the Bank's registered office.

Going concern

The Directors have prepared these financial statements on the going concern basis which assumes that the Bank will continue in operational existence for the foreseeable future having adequate funds to meet obligations as they fall due. AIB Mortgage Bank is dependent on its Parent, Allied Irish Banks, p.l.c. for continued funding and is therefore dependent on the going concern status of the Parent.

The financial statements of Allied Irish Bank p.l.c have been prepared on a going concern basis as the Directors of the AIB Group are satisfied, having considered the risks and uncertainties impacting the AIB Group, that it has the ability to continue in business for the foreseeable future. In making its assessment, the Directors have considered a wide range of information relating to present and future conditions. These have included financial plans, cash flow and funding forecasts, capital resources projections, all of which have been prepared under base and stress scenarios. The AIB Group Directors have also considered the AIB Group's ability to access funding and liquidity. In addition, the AIB Group Directors have considered the commitment of support provided to AIB by the Irish Government through the programme for restructuring the Irish banking system with AIB designated as one of the two 'Pillar Banks'.

The Directors of AIB Group are satisfied based on the clarity of confirmations received from the Central Bank of Ireland and public announcements by ECB, EU and IMF that in all reasonable circumstances the required liquidity and funding from the Central Bank/ ECB will be available to the Group during the period of assessment.

On the basis of the continued availability of funding from Allied Irish Banks, p.l.c to AIB Mortgage Bank the Directors of the Bank consider that it is appropriate to prepare the financial statements on a going concern basis at this time.

Directors' Report

The Directors and Secretary of the Bank are set out on page 1.

Directors' and Secretary's interests in shares
The beneficial interests of the Directors and the Secretary in office at 31 December 2012 and of their spouses and minor children in the shares of AIB Group companies are set out below. The shares referred to are €0.01 ordinary shares in Allied Irish Banks, p.l.c., the holding company.

	31 December* 2012	1 January * 2012
Ordinary shares		
Directors:		
Sean Cremen	**7,719**	7,719
Ivor Larkin	**6,580**	6,580
James Murphy	**18,315**	18,315
Jim O'Keeffe	**5,698**	5,698
Catherine Woods	**NIL**	NIL
Secretary:		
David Schorman	**8,453**	8,453

Share options
Details of the Directors' and the Secretary's options to subscribe for ordinary shares in Allied Irish Banks, p.l.c., are given below. The vesting of these options to the individuals concerned is dependent on Earnings Per Share ("EPS") targets being met by AIB. Subject thereto, the options outstanding at 31 December 2012 are exercisable at various dates between 2013 and 2015. Details are shown in the Register of Directors' and Secretary's Interests, which may be inspected at the Bank's registered office.

	31 December 2012	**1 January* 2012**	**Options lapsed during 2012**	**Weighted Average subscription price of options outstanding at 31 December 2012**
				€
Directors:				
Sean Cremen	**5,000**	7,500	2,500	13.09
Ivor Larkin	**2,500**	2,500	–	13.30
James Murphy	**5,000**	5,000	–	16.20
Jim O'Keeffe	**15,000**	22,000	7,000	14.03
Secretary				
David Schorman	**2,000**	2,000	–	13.30

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

*or date of appointment, if later

Directors' Report

Long term incentive plans
There were no conditional grants of awards of ordinary shares outstanding to Executive Directors or the Company Secretary at 31 December 2012.

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

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

There were no changes in the Directors' and Secretary's interests between 31 December 2012 and 22 March 2013.

Mr. Dave Keenan was appointed to the Board on 22 March 2013.

Directors and Secretary

The following Board changes occurred with effect from the dates shown:

- Mr. Jim O'Keeffe was appointed Executive Director (Managing) on 28 February 2012
- Mr. Michael Keegan resigned as an Executive Director on 31 March 2012
- Mr. Ivor Larkin was appointed Executive Director on 24 July 2012
- Mr. James Murphy was appointed Non-Executive Director on 18 December 2012
- Mr. Seymour Cresswell resigned as an Executive Director on 18 December 2012
- Mr. Sean Cremen resigned as an Executive Director on the 22 March 2013
- Mr. Dave Keenan was appointed Non-Executive Director and Chairman on 22 March 2013

Independent auditor
The auditor, KPMG, Chartered Accountants, have signified their willingness to continue in office under section 160 (2) of the Companies Act, 1963.

On behalf of the Board

Chairman: Dave Keenan

Managing Director: Jim O'Keeffe

Date: *26* March 2013

Statement of Directors' responsibilities in relation to the Financial Statements

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the financial statements in accordance with International Financial Reporting Standards ('IFRS') as issued by the IASB and subsequently adopted by the EU and applicable law.

The financial statements are required by law and IFRS as issued by the IASB and subsequently adopted by the EU to present fairly the financial position and performance of the Bank; the Companies Acts 1963 to 2012 provide in relation to such financial statements that references in the relevant part of the Act and to financial statements giving a true and fair view are references to their achieving a fair presentation.

In preparing the Bank's financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent; 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 keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the Bank and enable them to ensure that its financial statements comply with the Companies Acts 1963 to 2012 and the Asset Covered Securities Acts. They are also responsible for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities.

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

On behalf of the Board

Director: Dave Keenan

Director: Jim O'Keeffe

Date: 26 March 2013

Risk management report

Introduction
The Bank's approach to identifying and monitoring the principal risks and uncertainties facing the Bank is informed by risk factors. All of the Bank's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed on an AIB Group wide basis. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of the AIB Group's risk management framework.

1. Risk Factors

The Bank's dependence on the AIB Group
The Bank, as an integral member of the AIB Group, is dependent to a very large extent on AIB (and through it other members of the AIB Group) in relation to the origination and servicing of Irish residential loans, administration and accounting services, treasury services, hedging arrangements, debt funding, equity and regulatory capital and services relating to the issuance of Mortgage Covered Securities. To meet its funding requirements, the AIB Group has accessed a range of Central Bank liquidity facilities, including at times certain additional liquidity schemes introduced by central banks for market participants during periods of dislocation in the funding markets. In accessing Central Bank and other secured lending facilities, the AIB Group has relied significantly on its "Qualifying Liquid Assets" and "Contingent Funding" capacity. The curtailment or non-extension of the Central Bank liquidity facilities currently relied upon by the AIB Group, or the AIB Group's inability to access such facilities would require the AIB Group to seek alternative sources of funding.

The Bank is entirely dependent on the AIB Group to provide the necessary capital resources to meet minimum regulatory requirements. The AIB Group's target capital requirements as determined by the Central Bank under its Prudential Capital Assessment Review (PCAR) are currently core tier 1 ratio of 10.5% in the base scenario and 6% in a stress scenario, not including an allowance for an additional protective buffer. AIB Group has carried out extensive forward-looking stress tests on its capital adequacy position, including two European Banking Authority (EBA) stress tests carried out in the second half of 2011. The published results of both EBA stress tests confirmed that AIB did not require additional capital. However given the levels of uncertainty in the current economic climate there is the possibility that further losses over and above what is currently forecast could materialise. In the event that such losses are significantly greater than forecasted, the AIB Group's capital position could be eroded to the extent that it may have insufficient capital resources to provide to the Bank to meet the Bank's target regulatory requirements.

1.2 Exposure to the Irish Housing/Residential Loan Market
Since the beginning of 2007, the Irish residential property market has undergone a material negative correction as regards mortgage lending activity and residential property prices.

The Bank's exposure to credit risk is exacerbated when the collateral it holds cannot be realised or is liquidated at prices that are not sufficient to recover the full amount of the loan, which is most likely to occur during periods of illiquidity and depressed asset valuations, such as those currently being experienced.

Any such losses could have a material adverse effect on the Bank's future performance and results of operations. In addition, an increase in interest rates may lead to, amongst other things, further declines in collateral values, higher repayment costs and reduced recoverability which together with the aforementioned risks may adversely impact the Bank's earnings or require an increase in the expected cumulative impairment charge for the Bank.

1.3 The Bank's business activities must comply with increasing levels of regulatory requirements introduced as a result of failings in financial markets
In 2011 and 2012 there was an unprecedented level of new regulation issued by both by the Central Bank of Ireland and the EU, through a number of new or revised Codes and Directives as detailed below:

- The Corporate Governance Code for Credit Institutions and Insurance Undertakings was introduced on 1 January 2011 and it sets out the minimum requirements an institution must meet to promote effective governance.

Risk management report

1.3 The Bank's business activities must comply with increasing levels of regulatory requirements introduced as a result of failings in financial markets*(continued)*

- The Code of Conduct on Mortgage Arrears came into effect in June 2011, providing increased protection to the consumer particularly those in arrears situations.
- The revised Consumer Protection Code came into effect on the 1 January 2012.
- The Central Bank Reform Act introduced new fitness and probity requirements that apply to staff who are working in certain defined roles, requiring them to meet defined standards of fitness and probity. AIB implemented these requirements on a phased basis during 2012.
- Major change programmes were initiated across the Group to implement these new requirements spanning all business areas, processes and systems and we are operating fully into these codes now.

The Personal Insolvency Act, which was signed into law in December 2012, provides for the introduction of the new non-judicial debt settlement and for ammendments to the Bankruptcy Act. Early in 2013, it is expected that the newly established Insolvency Service of Ireland will issue relevant guidelines and publications and that in quarter 2, the Insolvency Service will begin to appoint Personal Insolvency Practitioners. A key risk arises from potential changes in customer behaviour and attitude to debt obligations given that the new legislation allows for the agreed settlement of unsecured debt and the settlement/restructuring of secured debts up to a maximum of €3 million. The inclusion of secured debt in the non-judicial process is unprecedented, and therefore, it is difficult to gauge its impact. While the Personal Insolvency Arrangement ("PIA") requires prior co-operation and engagement by Private Dwelling House ("PDH") borrowers under the MARP process, this requirement does not apply to other secured debtors. These factors could impact on the potential number of customers applying through the insolvency process, with potential negative consequences for the Group in terms of resourcing, impairment provisions and capital adequacy, with ensuring adverse Government, media and consumer reactions. It is recognised Personal Insolvency Practitioners ("PIP"), who have yet to be authorised, will play a key role in the effective implementation of the legislation as will the guideline living standards for applicants. While the Insolvency Service has given indications as to its intended approach in relation to these factors, there remains uncertainty that the controls will be adequate to mitigate the downside risk of changes to customer behaviour.

A number of new legislative proposals are currently being considered by the Oireachtas (the Irish National Parliament) including the Central Bank (Supervision and Enforcement Bill) 2011 and the Credit Reporting Bill 2012. Together with the high level of existing regulations the challenge of managing regulatory standards have posed a concomitant demand on AIB in terms of the deployment of business and IT resources which are expected to continue in 2013. Delivering this level of change has placed and will continue to place added risk on the organisation, including the challenge to meet tight delivery timelines in the face of competing priorities and resource demands. Changes in supervision and regulation, in particular in or applying to Ireland has and will continue to have a material impact on the Bank's business, products and services offered and the value of its assets.

Future changes in government policy, central bank monetary authority policy, EU/Eurozone policies, legislation or regulation or their interpretation relevant to the financial services industry in the markets which the Group operates may adversely affect its product range, distribution channels, funding sources, capital requirements and consequently, reported results and financing requirements. Any changes in the regulation of selling practices and solvency, funding and capital requirements could have a significant adverse effect on the Group's results of operations, financial condition and future prospects. Furthermore, new regulatory obligations regarding functional and operational arrangements within the Group may also have an adverse impact on the Group's results, financial conditions and prospects.

2. Risk Framework

2.1 Elements of the Risk Management Framework

The Bank assumes a variety of risks in undertaking its business activities. Risk is defined as any event that could damage the core earnings capacity of the Bank, increase earnings or cash-flow volatility, reduce capital, threaten business reputation or viability, and/or breach regulatory or legal obligations. The Bank has adopted the AIB Group Enterprise Risk Management approach to identifying, assessing and managing risks, the core aspects of which are described below:

Risk management report

2. Risk Framework *(continued)*
2.2 Risk Appetite
The Bank's risk appetite is defined as the maximum amount of risk that the Bank is prepared to accept in order to deliver on its strategic and business objectives. In June 2011, the Board approved a Risk Appetite Framework and within it a Risk Appetite Statement (RAS) which set out key limits across the Bank's material risks.

The Bank's risk profile is measured against its risk appetite on a quarterly basis and reported to the Bank's Executive Committee and the Board. Material breaches of risk appetite are escalated to the Board, the AIB Executive Risk Committee and the Central Bank. The RAS will be reviewed again later in 2013, upon commencement of the updated planning process.

2.3 Risk governance and risk management organisation
The Board has ultimate responsibility for the governance of all risk taking activity in the Bank. Senior Management are accountable for risk taking within the Board approved risk appetite. The Bank has adopted the AIB 'three lines of defence' framework in the delineation of accountabilities for risk governance.

Under the three lines of defence model, primary responsibility for risk management lies with line management. The AIB Group Risk Management function provides the second line of defence, providing independent oversight and challenge to business line managers.

The third line of defence is the AIB Group Internal Audit function which provides independent assurance to the Audit Committee of the Board on the design and effectiveness of the system of internal controls.

3. Individual Risk Types
This section provides details of the exposure to, and risk management of, the following individual risk types which have been identified through the AIB Group risk assessment process and which are relevant to AIB Mortgage Bank:-

3.1 Credit risk
3.2 Liquidity risk
3.3 Operational risk
3.4 Regulatory compliance risk
3.5 Non-trading interest rate risk

The 5 applicable risk types are discussed below.

3.1 Credit risk
Credit risk is defined as the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into and that pledged collateral does not fully cover amounts due to the Bank. The most significant credit risks assumed by the Bank arise from mortgage lending activities to customers in Ireland. Credit risk also arises on funds placed with AIB in respect of derivatives relating to interest rate risk management.

It is AIB Group policy to maintain sanctioning authority for residential mortgages independent of the sales function. A credit risk policy has been approved by the Board of Directors of the Bank, is subject to annual review and complies with AIB Group standards. Grading tools are used in the management of credit risk and an arrears management process operates to minimise the level of non-performing loans.

Net disposable income is the key factor in assessing repayment capacity. Repayment capacity is assessed by reference to the debt service ratio which measures the proportion of 'after tax' income required to service the proposed borrowing. When sanctioning mortgage credits, consideration is also given to the loan to value ratios, adequacy of security and the track record of the borrower.

The assessment of individual mortgage loans includes an interest rate stress test in compliance with requirements set by the Central Bank of Ireland.

Risk management report

3.1 Credit risk *(continued)*
The ratings derived from the grading process influence the management of individual loans. Special attention is paid to lower quality rated loans and, when appropriate, loans are transferred to special units to help avoid default or, when in default, to minimise loss.

The credit risk disclosures are aligned with CBI guidelines issued in December 2011.

The table below sets out the maximum exposure to credit risk that arises within the Bank. The table distinguishes between those assets that are carried in the Statement of Financial Position at amortised cost and those carried at fair value. The most significant credit risks arise from lending activities to customers and banks, derivatives relating to interest rate risk management and 'off-balance sheet' commitments. The credit risks arising from balances at Central Bank are deemed to be negligible based on their maturity and counterparty status.

Maximum exposure to credit risk*

			2012			2011
	Amortised Cost	**Fair Value**	**Total**	Amortised Cost	Fair Value	Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Derivatives financial instruments	**–**	**421**	**421**	–	409	409
Loans and receivables to banks	**498**	**–**	**498**	666	–	666
Loans and receivables to customers	**21,748**	**–**	**21,748**	22,444	–	22,444
Included elsewhere:						
Accrued interest	**30**	**–**	**30**	28	–	28
Other assets	**20**	**–**	**20**	34	–	34
	22,296	**421**	**22,717**	23,172	409	23,581
Loan commitments	**230**	**–**	**230**	239	–	239
Maximum exposure to credit risk	**22,526**	**421**	**22,947**	23,411	409	23,820

Risk identification and assessment*
All mortgage loans are subject to an individual underwriting process. In addition, credit risk is identified, assessed and measured through the use of credit rating and scoring tools for each borrower or transaction. The methodology used produces a quantitative estimate of the Probability of Default ("PD") for the borrower. This assessment is carried out at the level of the individual borrower or transaction and at portfolio level when relevant.

In the mortgage portfolio, which is characterised by a large number of customers with small individual exposures, risk assessment is largely informed through statistically based scoring techniques. Both application scoring for new customers and behavioural scoring for existing customers are used to assess and measure risk as well as to facilitate the management of the portfolio.

Risk management and mitigation*
AIB Mortgage Bank through AIB Group has an established credit process with a framework of a mortgage credit policy and delegated authorities, based on skill and experience, for the management and control of credit risk. Credit grading, scoring and monitoring systems accommodate the early identification and management of any deterioration in loan quality. The credit management system is underpinned by an independent system of credit review.

*Forms an integral part of the audited financial statements.

Risk management report

3.1 Credit risk *(continued)*
Risk management and mitigation* *(continued)*
In addition, the Board of AIB Mortgage Bank and the Board of AIB review and approve the credit policy for residential property mortgage loans.

Credit risk mitigation
The most significant and widely used credit risk mitigation tool available to the Bank is its own internal credit risk control framework.

Provisioning for impairment
The identification of loans for assessment as impaired is facilitated by the Bank's rating systems. Changes in the variables which drive the borrower's credit grade may result in the borrower being downgraded. This in turn influences the management of individual loans with special attention being paid to lower quality loans.

The grade of an exposure is one of the key factors used to determine if a case should be assessed for impairment. Loans are assessed for impairment, either individually or collectively, if they are past due typically for more than ninety days or the borrower exhibits, through lender assessment, an inability to meet his obligations to the Bank based on objective evidence of loss events (i.e. impairment triggers). The types of loss events considered as triggers for an impairment assessment include:

- national or local economic conditions that correlate with defaults on the assets in the portfolio, (e.g. an increase in the unemployment rate in the geographical area of the borrowers, a decrease in residential and/or commercial property prices in the relevant area, regulatory/government fiscal policy change or adverse changes in industry conditions that affect the borrowers in the group);
- significant financial difficulty of the issuer or obligor;
- observable data indicating a measurable decrease in estimated cash flows;
- 90+ days past due; and
- a request for a forbearance measure from the borrower.

Within its provisioning methodology, the AIB Group uses two types of provisions: a) specific; and b) incurred but not reported ("IBNR") – i.e. collective provisions for earning loans.

Specific provisions
Specific impairment provisions arise when the recovery of a specific loan or group of loans is in doubt based on specific impairment triggers as described above, and assessment that all the expected future cash flows either from the loan itself or from the associated collateral will not be sufficient to repay the loan. The amount of the specific impairment provision will reflect the financial position of the borrower and the net realisable value of any security held for the loan or group of loans. In practice, the specific impairment provision is the difference between the present value of expected future cash flows for the impaired loan(s) discounted at the original effective interest rate and the carrying value of the loan(s). When raising specific impairment provisions, AIB divides its impaired portfolio into two categories, namely individually significant and individually insignificant.

Individually significant impairment
Each entity within AIB Group sets a threshold above which cases are assessed on an individual basis. The individually significant threshold for AIB Mortgage Bank is less than €500,000. For those loans identified as being impaired, the individual impairment provision is calculated by discounting the expected future cash flows at the exposure's effective interest rate and comparing the result (the estimated recoverable amount) to the carrying amount of the loan to determine the level of provision required. The key inputs to the discounted cash flow models are the estimated amount and timing of cash flows (to include scheduled repayments, or payments due from realisation of security) and the exposure's effective interest rate. The time period likely to be required to realise the collateral and receive the cash flows is taken into account in estimating the future cash flows and discounting these back to present value.

*Forms an integral part of the audited financial statements.

Risk management report

3.1 Credit risk *(continued)*
Risk management and mitigation* *(continued)*
Individually significant impairment (continued)
In assessing the value of collateral for impaired mortgage loans, the Bank uses a peak to trough price decline of 55% as a base. In certain circumstances realisation costs of 10% are deducted. For individually significant loans, other factors, such as recent transactional evidence or local knowledge are considered, which can result in higher or lower discounts to collateral valuations.

Individually insignificant impairment
The calculation of an impairment charge for loans below the "significant" threshold is undertaken on a collective basis. Loans are grouped together in homogeneous pools sharing common characteristics and impairment is calculated by reference to the loss history experience/expected cashflows for the pool of impaired loans (i.e. amount and timing of cash flows / loss given default).

The methodology applies a probability of a loan going to repossession based on its individual characteristics e.g. time in arrears. Given the lack of repossession experience in the portfolio in recent years the actual observed instances of loans going from 90+ days past due to less than 90+ is used as a proxy for the aformentioned probability of going to/not going to repossession. The provision applied given the default to repossession is arrived at following the application of a peak to trough price decline of 55% plus additional firesale and disposal costs (range 10% to 20%).

When a loan has been subjected to a specific provision and the prospects for recovery do not improve, a point will come when it may be concluded that there is no realistic prospect of recovery. When that point is reached, the amount of the loan which is considered to be beyond prospect of recovery is charged off.

Collective impairment for performing book (Incurred but not reported loss)
IBNR provisions are maintained to cover loans which are impaired at the Statement of Financial Position date and, while not specifically identified, are known from experience to be present in the portfolio of loans but have not yet emerged. IBNR provisions can only be recognised for incurred losses and are not permitted for losses that are expected to happen as a result of likely future events. IBNR provisions are determined by reference to loss experience in the portfolios and to the credit environment at the Statement of Financial Position date.

IBNR provisions are maintained at levels that are deemed appropriate by management having considered: credit grading profiles and grading movements; arrears profiles; forbearance activity; historic loan loss rates; recent loss experience, changes in credit management procedures, processes and policies; local and international economic climates; and portfolio profile/industry conditions.

The approach used for the collective evaluation of impairment is to split the performing financial assets into pools on the basis of similar risk characteristics such as, owner-occupier/buy-to-let. The appropriate level of IBNR is calculated based on: i) the likely provision rates for these portfolios through the emergence period by reference to the Bank's near term provision plans/forecasts which are informed by the recent specific provision experience; and ii) an assessment of higher risk portfolios, which include but are not limited to, a) the non-impaired forborne mortgages, b) loans graded vulnerable which include loans in advanced arrears and iii) loans >90 days past due but not impaired. The assessment of the level of likely incurred loss in these higher risk portfolios is informed, where appropriate, by independent credit reviews of these portfolios.

The Emergence Period is key in determining the level of collective provisions. The Emergence Period is determined by taking into account current credit management practices, historical evidence of assets moving from "good" to "bad" as a result of a "loss event" and will include actual case studies. The Emergence Period applied in AIB Mortgage Bank is 6 months.

The level of IBNR provisions is reviewed quarterly to ensure it remains appropriate and adequate.

Risk monitoring and reporting*
AIB employs a dedicated approach to loan workout and to monitoring and proactively managing impaired loans. The Arrears Support Unit focuses on managing weaker credits.

*Forms an integral part of the audited financial statements.

Risk Management Report

3.1 Credit risk *(continued)*
Risk management and mitigation* *(continued)*
Risk monitoring and reporting (continued)*
Relevant credit risk information is reported in a timely manner to the appropriate level to enable informed management decision making.

Credit managers receive sufficient account and customer information to pro-actively manage the Bank's credit risk exposures at a transaction and relationship level.

Additional information on credit risk

Individually impaired loans by geographic location and sector*

Republic of Ireland	**2012 € m**	2011 € m
Home Mortgages	**4,561**	2,737
	4,561	2,737

Provision cover table*

Republic of Ireland	**Impaired Loan Balance**	**Specific Provision**	**Specific Provision Cover %**
Home mortgages – 31 December 2012	**4,561**	**1,774**	**39%**
Home mortgages – 31 December 2011	2,737	953	35%

Collateral and other credit enhancements*
The Bank takes collateral in support of lending transactions for the purchase of residential property. There are clear policies in place which set out the type of property acceptable as collateral and the relationship of loan to property value. All properties are required to be fully insured and be subject to a legal charge in favour of the Bank.

Collateral valuations are required at the time of origination of each residential mortgage. The fair values are based on the property values at origination or most recent valuation, and applying the CSO (Ireland) index to these values to take account of price movements in the interim.

The following pages provide details of;
- – Fair value of residential mortgage collateral
- – Credit profile, analysis of the owner occupier and buy-to-let portfolios by arrears and provisions
- – Fair value of residential mortgage collateral
- – Residential mortgages which are past due but not impaired
- – Residential mortgages which are impaired
- – Forbearance:
  - - Owner occupier
  - - Buy-to-let
  - - Total
- – Repossessions
- – Loan to value profile
- – Origination profile

*Forms an integral part of the audited financial statements.

Risk management report

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

	2012 Owner-Occupier € m	**2012 Buy-to-Let € m**	**2012 Total € m**	2011 Owner-Occupier € m	2011 Buy-to-Let € m	2011 Total €m
Total residential mortgages	**16,963**	**6,793**	**23,756**	16,894	7,107	24,001
In arrears (>30 days past due)[(1)]	**2,084**	**3,012**	**5,096**	1,330	2,193	3,523
In arrears (> 90 days past due)[(1)]	**1,897**	**2,908**	**4,805**	1,086	2,011	3,097
Of which impaired	**1,768**	**2,793**	**4,561**	895	1,842	2,737
Statement of financial position specific provisions	**622**	**1,152**	**1,774**	275	678	953
Statement of financial position IBNR provisions	**156**	**78**	**234**	298	306	604
Income statement specific provisions	**365**	**499**	**864**	208	585	793
Income statement IBNR provisions	**(141)**	**(229)**	**(370)**	148	93	241
Specific provisions as a % of impaired loans cover	**35.2%**	**41.3%**	**38.9%**	30.7%	36.8%	34.8%

[(1)] Includes all impaired loans whether past due or not.

*Forms an integral part of the audited financial statements.

Risk management report

Additional information on credit risk *(continued)*

Fair value of residential mortgage collateral*

The following tables show the fair value (FV) of collateral held for residential mortgages at 31 December 2012 and 31 December 2011:

				2012
Fully collateralised[(1)]	**Neither past due nor impaired € m**	**Past due but not impaired € m**	**Impaired € m**	**Total € m**
Loan-to-value ratio:				
Less than 50%	**2,631**	**122**	**171**	**2,924**
50%-70%	**2,536**	**129**	**217**	**2,882**
71%-80%	**1,496**	**73**	**170**	**1,739**
81%-90%	**1,715**	**70**	**207**	**1,992**
91%-100%	**1,542**	**58**	**259**	**1,859**
	9,920	**452**	**1,024**	**11,396**
Partially collateralised				
Collateral value relating to loans over 100% LTV	**6,311**	**329**	**2,388**	**9,028**
Total collateral value	**16,231**	**781**	**3,412**	**20,424**
Gross residential mortgages	**18,276**	**919**	**4,561**	**23,756**
Statement of financial position specific provisions			**(1,774)**	**(1,774)**
Statement of financial position IBNR provisions				**(234)**
Net residential mortgages				**21,748**

[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.

Risk management report

Additional information on credit risk *(continued)*

Fair value of residential mortgage collateral* *(continued)*

				2011
Fully collateralised[1]	Neither past due nor impaired € m	Past due but not impaired € m	Impaired € m	Total € m
Loan to value ratio:				
Less than 50%	2,840	102	131	3,073
50%-70%	2,731	117	149	2,997
71%-80%	1,482	68	100	1,650
81%-90%	1,567	65	122	1,754
91%-100%	1,632	77	177	1,886
	10,252	429	679	11,360
Partially collateralised				
Collateral value relating to loans over 100% LTV	7,672	480	1,406	9,558
Total collateral value	17,924	909	2,085	20,918
Gross residential mortgages	20,180	1,084	2,737	24,001
Statement of financial position specific provisions			(953)	(953)
Statement of financial position IBNR provision				(604)
Net residential mortgages				22,444

[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.

Risk management report

Additional information on credit risk *(continued)*

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

			2012
	Owner-Occupier	**Buy-to-Let**	**Total**
	€ m	**€ m**	**€ m**
1 - 30 days	**269**	**115**	**384**
31 - 60 days	**117**	**67**	**184**
61 - 90 days	**70**	**37**	**107**
91 - 180 days	**75**	**60**	**135**
181 - 365 days	**39**	**34**	**73**
Over 365 days	**15**	**21**	**36**
Total past due but not impaired	**585**	**334**	**919**

			2011
	Owner-Occupier	Buy-to-Let	Total
	€ m	€ m	€ m
1-30 days	174	124	298
31-60 days	152	111	263
61-90 days	92	71	163
91-180 days	140	101	241
181-365 days	44	51	95
Over 365 days	7	17	24
Total past due but not impaired	609	475	1,084

€919m or 3.9% of the mortgage book was past due but not impaired at 31 December 2012 compared to €1,084m or 4.5% at 31 December 2011. Of the loan book that was past due but not impaired, €384m or 42% was 30 days or less past due but not impaired (31 December 2011: €298m or 28%). Loans past due more than 90 days but not impaired amounted to €244m, and have decreased from €360m at 31 December 2011.

*Forms an integral part of the audited financial statements.

Risk management report

Additional information on credit risk *(continued)*

Arrears profile of mortgages which are impaired

Impaired loans	**Owner-Occupier €m**	**Buy-to-Let €m**	**2012* Total €m**
Not past due	**469**	**871**	**1,340**
1 - 30 days	**106**	**145**	**251**
31 - 60 days	**84**	**137**	**221**
61 - 90 days	**64**	**84**	**148**
91 - 180 days	**185**	**251**	**436**
181 - 365 days	**255**	**390**	**645**
Over 365 days	**605**	**915**	**1,520**
Total impaired	**1,768**	**2,793**	**4,561**

	Owner-Occupier €m	Buy-to-Let €m	2011 Total €m
Not past due	165	612	777
1 - 30 days	25	92	117
31 - 60 days	33	121	154
61 - 90 days	21	85	106
91 - 180 days	100	198	298
181 - 365 days	219	284	503
Over 365 days	332	450	782
Total impaired	895	1,842	2,737

Of the residential mortgage portfolio that was impaired at 31 December 2012, €1,340m or 30% was not past due (31 December 2011: €777m or 29%). A further €620m or 14% of the impaired portfolio was less than 90 days past due at 31 December 2012 (31 December 2011: €377m or 14%).

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

*Forms an integral part of the audited financial statements.

Risk management report

Forbearance
The following tables analyse by type of forbearance, (i) owner-occupier, (ii) buy-to-let and (iii) total residential mortgages that were subject to forbearance measures at 31 December 2012 and 31 December 2011:

Residential owner-occupier mortgages

						2012*
				Loans > 90 days in arrears and/ or impaired		**Loans neither > 90 days in arrears nor impaired**
	Number	**Total Balance € m**	**Number**	**Balance € m**	**Number**	**Balance € m**
Interest only	**4,089**	**839**	**1,905**	**464**	**2,184**	**375**
Reduced payment (greater than interest only)	**1,547**	**350**	**805**	**215**	**742**	**135**
Payment moratorium	**563**	**95**	**225**	**43**	**338**	**52**
Arrears Capitalisation	**1,750**	**373**	**1,109**	**276**	**641**	**97**
Term Extension	**2,075**	**269**	**87**	**11**	**1,988**	**258**
Other	**1**	**1**	**–**	**–**	**1**	**1**
Total	**10,025**	**1,927**	**4,131**	**1,009**	**5,894**	**918**

						2011
				Loans > 90 days in arrears and/ or impaired		Loans neither >90 days in arrears nor impaired
	Number	Total Balance € m	Number	Balance € m	Number	Balance € m
Interest only	6,974	1,484	1,370	328	5,604	1,156
Reduced payment (greater than interest only)	712	150	219	50	493	100
Payment moratorium	1,113	214	414	83	699	131
Arrears Capitalisation	844	171	358	91	486	80
Term Extension	1,710	230	35	5	1,675	225
Total[(1)]	11,353	2,249	2,396	557	8,957	1,692

*Forms an integral part of the audited financial statements.

Risk management report

Forbearance *(continued)*

Buy-to-let mortgages

						2012*
			Loans > 90 days in arrears and/or impaired		**Loans neither > 90 days in arrears nor impaired**	
	Number	**Total Balance € m**	**Number**	**Balance € m**	**Number**	**Balance €m**
Interest only	**4,562**	**1,157**	**2,774**	**789**	**1,788**	**368**
Reduced payment (greater than interest only)	**880**	**211**	**505**	**126**	**375**	**85**
Payment moratorium	**64**	**15**	**37**	**9**	**27**	**6**
Arrears capitalisation	**1,777**	**474**	**1,469**	**417**	**308**	**57**
Term extension	**616**	**93**	**66**	**14**	**550**	**79**
Total	**7,899**	**1,950**	**4,851**	**1,355**	**3,048**	**595**

						2011
			Loans > 90 days in arrears and or impaired		Loans neither > 90 days in arrears nor impaired	
	Number	Total Balance € m	Number	Balance € m	Number	Balance € m
Interest only	5,923	1,490	2,024	639	3,899	851
Reduced payment (greater than interest only)	379	89	105	28	274	61
Payment moratorium	124	37	74	27	50	10
Arrears capitalisation	801	224	546	157	255	67
Term extension	500	81	28	7	472	74
Total[(1)]	7,727	1,921	2,777	858	4,950	1,063

*Forms an integral part of the audited financial statements.

Risk management report

Forbearance *(continued)*

Total mortgage portfolio

						2012*
			Loans > 90 days in arrears and/or impaired		**Loans neither > 90 days in arrears nor impaired**	
	Number	**Total Balance**	**Number**	**Balance**	**Number**	**Balance**
Interest only	**8,651**	**1,996**	**4,679**	**1,253**	**3,972**	**743**
Reduced payment (greater than interest only)	**2,427**	**561**	**1,310**	**341**	**1,117**	**220**
Payment moratorium	**627**	**110**	**262**	**52**	**365**	**58**
Arrears capitalisation	**3,527**	**847**	**2,578**	**693**	**949**	**154**
Term extension	**2,691**	**362**	**153**	**25**	**2,538**	**337**
Other	**1**	**1**	**–**	**–**	**1**	**1**
Total	**17,924**	**3,877**	**8,982**	**2,364**	**8,942**	**1,513**

						2011
			Loans > 90 days in arrears and/or impaired		Loans neither > 90 days in arrears nor impaired	
	Number	Total Balance	Number	Balance	Number	Balance
Interest only	12,897	2,974	3,394	967	9,503	2,007
Reduced payment (greater than interest only)	1,091	239	324	78	767	161
Payment moratorium	1,237	251	488	110	749	141
Arrears capitalisation	1,645	395	904	248	741	147
Term extension	2,210	311	63	12	2,147	299
Total[1]	19,080	4,170	5,173	1,415	13,907	2,755

[1] The comparatives relating to forbearance for 2011 have been updated to reflect AIB Mortgage Bank only. Previously this information was presented on an AIB Group basis.

AIB has developed a Mortgage Arrears Resolution Strategy (‘MARS’) for dealing with mortgage customers in difficulty or likely to be in difficulty. MARS builds on and formalises AIB Group’s Mortgage Arrears Resolution Process, under which short-term mortgage forbearance solutions were provided to customers in financial difficulty for the last number of years. MARS includes new longer-term forbearance solutions which were devised in 2012 to assist existing primary residential mortgage customers in difficulty.

Of the total residential mortgage portfolio of €23.8bn (2011: €24.0bn), €3.9bn (16%) was subject to forbearance measures at 31 December 2012, compared to €4.2bn (17%) at 31 December 2011. The majority (51%) of the loans that were subject to forbearance measures at 31 December 2012 were granted a period of interest only payments (2011: 71%). €2.4bn (61%) of the loans under forbearance were greater than 90 days past due and/or impaired at 31 December 2012, compared to €1.4bn (34%) at 31 December 2011.

*Forms an integral part of the audited financial statements.

Risk management report

Forbearance *(continued)*

Credit profile of residential mortgages in forbearance

Forbearance stock - past due but not impaired

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was past due but not impaired at 31 December 2012 and 31 December 2011:

			2012*
	Owner-Occupier € m	**Buy-to-Let € m**	**Total € m**
1 - 30 days	**67**	**30**	**97**
31 - 60 days	**36**	**20**	**56**
61 - 90 days	**31**	**12**	**43**
91 - 180 days	**40**	**24**	**64**
181 - 365 days	**21**	**12**	**33**
Over 365 days	**8**	**10**	**18**
Total past due but not impaired	**203**	**108**	**311**

			2011
	Owner-Occupier € m	Buy-to-Let € m	Total € m
1 - 30 days	82	45	127
31 - 60 days	68	44	112
61 - 90 days	53	32	85
91 - 180 days	89	36	125
181 - 365 days	34	20	54
Over 365 days	3	8	11
Total past due but not impaired	329	185	514

€311m or 8% of the residential mortgage portfolio that was subject to forbearance measures at 31 December 2012 was past due but not impaired at 31 December 2012 (31 December 2011: €514m or 12%). Of the portion of the portfolio that was past due but not impaired, €97m or 31% was 30 days or less past due but not impaired (31 December 2011: €127m or 25%). €115m (37%) of the portfolio was more than 90 days past due, compared to €190m (37%) at 31 December 2011.

*Forms an integral part of the audited financial statements.

Risk management report

Forbearance *(continued)*

Credit profile of residential mortgages in forbearance

Forbearance stock - impaired

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was impaired at 31 December 2012 and 31 December 2011:

			2012*
	Owner-Occupier € m	**Buy-to-Let € m**	**Total € m**
Not past due	**319**	**508**	**827**
1 - 30 days	**77**	**89**	**166**
31 - 60 days	**58**	**83**	**141**
61 - 90 days	**36**	**50**	**86**
91 - 180 days	**109**	**132**	**241**
181 - 365 days	**132**	**192**	**324**
Over 365 days	**209**	**255**	**464**
Total impaired	**940**	**1,309**	**2,249**

			2011
	Owner-Occupier € m	Buy-to-Let € m	Total € m
Not past due	105	352	457
1 - 30 days	19	50	69
31 - 60 days	20	78	98
61 - 90 days	12	106	118
91 - 180 days	57	21	78
181 - 365 days	118	107	225
Over 365 days	100	80	180
Total impaired	431	794	1,225

Of the residential mortgage portfolio that was subject to forbearance measures and impaired at 31 December 2012, €827m or 37% was not past due at 31 December 2012 (31 December 2011: €457m or 37%). A further €393m or 17% of the impaired portfolio was less than 90 days past due at 31 December 2012 (31 December 2011: €285m or 23%).

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

*Forms an integral part of the audited financial statements.

Risk management report

Forbearance *(continued)*

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

The following table profiles the residential mortgage portfolio that was subject to forbearance measures by the indexed loan-to-value ratios at 31 December 2012 and 31 December 2011:

			2012*
	Owner-Occupier € m	**Buy-to-Let € m**	**Total € m**
Less than 50%	**214**	**64**	**278**
50% – 70%	**220**	**98**	**318**
71% – 80%	**143**	**71**	**214**
81% – 90%	**148**	**80**	**228**
91% – 100%	**143**	**112**	**255**
101% – 120%	**292**	**284**	**576**
121% – 150%	**377**	**437**	**814**
Greater than 150%	**390**	**804**	**1,194**
Total forbearance	**1,927**	**1,950**	**3,877**

			2011
	Owner-Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	269	69	338
50% – 70%	298	115	413
71% – 80%	177	75	252
81% – 90%	170	101	271
91% – 100%	163	132	295
101% – 120%	387	311	698
121% – 150%	416	478	894
Greater than 150%	369	640	1,009
Total forbearance	2,249	1,921	4,170

Of the residential mortgage portfolio that was subject to forbearance measures at 31 December 2012, 55% of owner-occupier and 78% of buy-to-let mortgages were in negative equity (31 December 2011: 51% and 74% respectively), whilst 67% of the total portfolio subject to forbearance measures was in negative equity at 31 December 2012 (31 December 2011: 62%).

*Forms an integral part of the audited financial statements.

Risk management report

Repossessions (1)

The number (stock) of repossessions is set out below:

	2012 * **Number of repossessions**	**€m Balance Outstanding**
Owner-occupier	**23**	**6**
Buy-to-let	**37**	**10**
Total	**60**	**16**

	2011 Number of repossessions	€ m Balance Outstanding
Owner-Occupier	20	5
Buy-to-let	29	10
Total	49	15

(1) The number of repossessed residential properties presented relates to those held as security for residential mortgages only.

The following is an analysis of the residential properties that were disposed of during 2012 and 2011:

	Number of disposals	**Balance outstanding at repossession € m**	**Gross sales proceeds € m**	**Costs to sell € m**	**Loss on sale (1) € m**	**2012* Average LTV at sale price %**
Owner-occupier	**8**	**2**	**1**	**–**	**1**	**211%**
Buy-to-let	**9**	**4**	**1**	**–**	**3**	**357%**
Total residential	**17**	**6**	**2**	**–**	**4**	**279%**

	Number of disposals	Balance outstanding at repossession € m	Gross sales proceeds € m	Costs to sell € m	Loss on sale (1) € m	2011 Average LTV at sale price %
Owner-occupier	2	1	1	-	-	156%
Buy-to-let	9	3	1	-	2	238%
Total residential	11	4	2	-	2	222%

(1) Before specific impairment provisions.

*Forms an integral part of the audited financial statements.

Risk management report

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

The property values used in the completion of the following loan-to-value tables are determined with reference to the original or most recent valuation, indexed to the Central Statistics Office ("CSO") Residential Property Price Index. The CSO Residential Property Price Index for December 2012 reported that national residential property prices were 50% lower than their highest level in early 2007 and reported an annual fall in residential property prices of 4.5% in 2012. Comparative figures as reported by the CSO in December 2011 were 47% and 16.7% respectively.

Actual and average LTV across mortgage portfolios

The following tables profile the residential mortgage portfolio by the indexed loan-to-value ('LTV') ratios at 31 December 2012 and 2011 and the weighted average indexed LTV ratios for elements of the book.

	Owner-Occupier € m	Buy-to-let € m	2012* Total € m
Less than 50%	**2,462**	**462**	**2,924**
50%-70%	**2,311**	**571**	**2,882**
71%-80%	**1,357**	**382**	**1,739**
81%-90%	**1,572**	**420**	**1,992**
91%-100%	**1,385**	**474**	**1,859**
101-120%	**2,751**	**1,031**	**3,782**
121%-150%	**2,958**	**1,436**	**4,394**
Greater than 150%	**2,167**	**2,017**	**4,184**
Total	**16,963**	**6,793**	**23,756**
Weighted average indexed LTV(1):			
Stock of residential mortgages at year end	**99%**	**126%**	**107%**
New residential mortgages during year	**77%**	**60%**	**76%**
Impaired mortgages	**125%**	**149%**	**140%**

*Forms an integral part of the audited financial statements.

Risk management report

Loan-to-value (LTV) (index linked) information *(continued)*

	Owner-Occupier € m	Buy-to-let € m	2011 Total € m
Less than 50%	2,587	486	3,073
50%-70%	2,355	642	2,997
71%-80%	1,241	409	1,650
81%-90%	1,274	480	1,754
91%-100%	1,320	566	1,886
101-120%	3,062	1,162	4,224
121%-150%	3,021	1,578	4,599
Greater than 150%	2,034	1,784	3,818
Total	16,894	7,107	24,001
Weighted average indexed LTV[(1)] [(2)]:			
Stock of residential mortgages at year end	98%	122%	105%
New residential mortgages during year	73%	60%	72%
Impaired mortgages	118%	145%	137%

[(1)] Weighted average indexed LTV's are the individual indexed LTV calculations weighted by the mortgage balance against each property.
[(2)] Arising from changes made to the method of calculating the weighted average indexed loan-to-value ratios in 2012, comparative figures for 2011 have been adjusted.

46% of the owner-occupier and 66% of the buy-to-let mortgages were in negative equity at 31 December 2012 (31 December 2011: 48% and 64% respectively). The weighted average indexed loan-to-value ratio for the total portfolio was 107% at 31 December 2012 (31 December 2011: 105%), whilst the weighted average indexed loan-to-value of the impaired portfolio was at 140% (31 December 2011: 137%), reflecting the decrease in property prices in the period. The weighted average indexed loan-to-value ratio of new mortgages issued during 2012 was 76% (31 December 2011: 72%).

AIB Mortgage Bank

Risk management report

Loan-to-value (LTV) (index linked) information *(continued)*

Neither past due nor impaired

The following tables profile the residential mortgage portfolio that was neither past due nor impaired by the indexed loan to value ratios at 31 December 2012 and 31 December 2011.

	Owner-Occupier € m	**Buy-to -Let € m**	**2012* Total € m**
Less than 50%	**2,256**	**375**	**2,631**
50% -70%	**2,093**	**443**	**2,536**
71%-80%	**1,212**	**284**	**1,496**
81%-90%	**1,409**	**306**	**1,715**
91%-100%	**1,223**	**319**	**1,542**
101%-120%	**2,398**	**598**	**2,996**
121%-150%	**2,448**	**695**	**3,143**
Greater than 150%	**1,571**	**646**	**2,217**
Total	**14,610**	**3,666**	**18,276**

	Owner-Occupier € m	Buy-to -Let € m	2011 Total € m
Less than 50%	2,424	416	2,840
50%-70%	2,195	536	2,731
71%-80%	1,142	340	1,482
81%-90%	1,176	391	1,567
91%-100%	1,220	412	1,632
101-120%	2,831	800	3,631
121%-150%	2,707	986	3,693
Greater than 150%	1,697	915	2,612
Total	15,392	4,796	20,188

Of the residential mortgages that were neither past due nor impaired at 31 December 2012, 44% of owner-occupier and 53% of buy-to-let mortgages were in negative equity (31 December 2011: 47% and 56% respectively). In terms of the total portfolio that was neither past due nor impaired, 46% was in negative equity at 31 December 2012 (31 December 2011: 49%).

*Forms an integral part of the audited financial statements.

Risk management report

Loan-to-value (LTV) (index linked) information *(continued)*

Past due but not impaired

The following tables profile the residential mortgage portfolio that was past due but not impaired at 31 December 2012 and 31 December 2011.

	Owner-Occupier	**Buy-to-let**	**2012* Total**
	€ m	**€ m**	**€ m**
Less than 50%	**100**	**22**	**122**
50%-70%	**100**	**29**	**129**
71%-80%	**53**	**20**	**73**
81%-90%	**44**	**26**	**70**
91%-100%	**38**	**20**	**58**
101-120%	**73**	**49**	**122**
121%-150%	**93**	**71**	**164**
Greater than 150%	**84**	**97**	**181**
Total	**585**	**334**	**919**

	Owner-Occupier	Buy-to-let	2011 Total
	€ m	€ m	€ m
Less than 50%	82	20	102
50%-70%	80	37	117
71%-80%	46	22	68
81%-90%	42	23	65
91%-100%	39	38	77
101-120%	99	90	189
121%-150%	113	113	226
Greater than 150%	108	132	240
Total	609	475	1,084

Of the residential mortgages that were past due but not impaired at 31 December 2012, 43% of owner-occupier and 65% of buy-to-let mortgages were in negative equity (31 December 2011: 53% and 70% respectively). In terms of the total portfolio that was past due but not impaired, 51% was in negative equity at 31 December 2012 (31 December 2011: 60%).

*Forms an integral part of the audited financial statements.

Risk management report

Loan-to-value (LTV) (index linked) information *(continued)*

Greater than 90 days past due and/or impaired

The following tables profile the residential mortgage portfolio that was greater than 90 days past due and/or impaired by the indexed LTV ratios at 31 December 2012 and 31 December 2011.

	Owner-Occupier	**Buy-to-let**	**2012* Total**
	€ m	**€ m**	**€ m**
Less than 50%	**136**	**71**	**207**
50%-70%	**142**	**111**	**253**
71%-80%	**101**	**83**	**184**
81%-90%	**127**	**95**	**222**
91%-100%	**133**	**140**	**273**
101-120%	**295**	**400**	**695**
121%-150%	**431**	**690**	**1,121**
Greater than 150%	**532**	**1,318**	**1,850**
Total	**1,897**	**2,908**	**4,805**

	Owner-Occupier	Buy-to-let	2011 Total
	€ m	€ m	€ m
Less than 50%	115	58	173
50%-70%	107	85	192
71%-80%	68	55	123
81%-90%	69	73	142
91%-100%	74	124	198
101-120%	158	304	462
121%-150%	235	516	751
Greater than 150%	260	796	1,056
Total	1,086	2,011	3,097

Of the residential mortgages that were greater than 90 days past due and/or impaired at 31 December 2012, 66% of owner-occupier and 83% of buy-to-let mortgages were in negative equity (31 December 2011: 60% and 80% respectively). In terms of the total portfolio that was greater than 90 days past due and/or impaired, 76% was in negative equity at 31 December 2012 (31 December 2011: 73%).

*Forms an integral part of the audited financial statements.

Risk management report

Residential Mortgages by year of origination

The following tables profile the mortgage book and impaired mortgage book at 31 December 2012 and 2011 by year of origination.

				2012*
	Mortgage Portfolio		Impaired Mortgage Portfolio	
	Number	Balance	Number	Balance
		€ m		€ m
1996 and before	**3,072**	**52**	**287**	**6**
1997	**1,207**	**32**	**137**	**4**
1998	**1,986**	**69**	**217**	**11**
1999	**2,646**	**117**	**263**	**17**
2000	**3,363**	**184**	**344**	**30**
2001	**3,709**	**238**	**344**	**31**
2002	**6,202**	**539**	**632**	**78**
2003	**9,870**	**1,031**	**1,166**	**178**
2004	**12,904**	**1,657**	**1,742**	**327**
2005	**16,899**	**2,593**	**2,806**	**623**
2006	**21,220**	**4,034**	**4,109**	**1,110**
2007	**19,880**	**4,007**	**3,531**	**1,029**
2008	**18,832**	**3,775**	**2,539**	**789**
2009	**13,222**	**2,349**	**932**	**255**
2010	**8,091**	**1,365**	**233**	**62**
2011	**3,770**	**621**	**48**	**11**
2012	**6,629**	**1,093**	**–**	**–**
Total	**153,502**	**23,756**	**19,330**	**4,561**

*Forms an integral part of the audited financial statements.

Risk management report

Residential Mortgages by year of origination *(continued)*

				2011
		Mortgage Portfolio		Impaired Mortgage Portfolio
	Number	Balance	Number	Balance
		€ m		€ m
1996 and before	3,686	68	242	5
1997	1,586	40	114	4
1998	2,138	82	159	8
1999	2,833	136	214	15
2000	3,590	209	249	21
2001	3,886	268	236	21
2002	6,738	599	415	51
2003	10,263	1,127	721	111
2004	13,352	1,786	1,057	206
2005	17,330	2,760	1,580	374
2006	21,640	4,251	2,331	689
2007	20,240	4,208	1,882	600
2008	19,089	3,957	1,326	470
2009	13,527	2,475	422	135
2010	8,216	1,420	105	27
2011	3,806	615	–	–
Total	151,920	24,001	11,053	2,737

The tables show that 16% of the mortgage book originated before 2005, with such loans representing 15% of the impaired mortgage book at 31 December 2012 (2011:18% originated before 2005, of which 16% was impaired). A further 61% of the mortgage book originated between 2005 and 2008 with such loans representing 78% of the impaired mortgage book (2011: 63% originated between 2005 and 2008, of which 78% was impaired). The remainder of the book (23%) originated since 2008 and represents 7% of the impaired mortgage book (2011:19% originated since 2008, of which 6% was impaired).

Further information on credit risk

— Further information on credit risk can be found in the notes to the financial statements.
— Derivative financial instruments *(note 7)*.
— Loans and receivables to banks *(note 8)*.
— Loans and receivables to customers *(note 9)*.
— Provisions for impairment of loans and receivables *(note 5)*.

Risk management report

3.2 Liquidity risk*

Liquidity risk is the exposure to loss from not having sufficient funds available at an economic price to meet actual and contingent commitments. The objective of liquidity management is to ensure that, at all times, the Bank holds sufficient funds to meet its contracted and contingent commitments and regulatory requirements, at an economic price.

AIB Mortgage Bank's liquidity risk is managed as part of the overall AIB Group liquidity management. This includes the risk identification and assessment, risk management and mitigation, and risk monitoring and reporting processes.

Funding and Liquidity

The funding and liquidity policy as approved by the Board of Directors of the Bank sets out the forms of funding which can be used by the Bank to meet its liquidity requirements – see below. It also sets out the outsourcing arrangements which have been established with Allied Irish Banks p.l.c. to source and manage the funding and liquidity requirements. The policy also specifies reporting requirements with respect to funding and liquidity management.

Funding

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 ACS Acts;
(b) borrowing funds from Allied Irish Banks p.l.c.;
(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) wholesale and corporate market deposit taking; and
(e) capital funding to ensure at a minimum compliance with the capital adequacy requirements of the Central Bank of Ireland.

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

Liquidity

The Central Bank of Ireland requires credit institutions to comply with a cashflow maturity mismatch approach for the management of their liquidity. This involves credit institutions analysing their cash flows on a group-wide basis under various headings and placing them in pre-determined time bands depending on when the cash is received or paid out. Limits are imposed on the group on the first (0-8 days) and the second (8-31 days) time bands and monitoring ratios will be calculated for subsequent time bands. These requirements apply to AIB on a consolidated basis rather than to the Bank on a stand alone.

The primary liquidity requirements of the Bank are to have sufficient funds available at an economic price to meet its commitments to pay interest and principal to holders of the Bank's Mortgage Covered Securities, to repay short term borrowings under the MBPN Facility and to lend to mortgage customers in accordance with outstanding offer letters.

The Bank's liquidity risk is managed as part of the overall AIB Group liquidity management.

AIB Treasury through the Outsourcing and Agency Agreement:

— supports the liquidity management requirements of the Bank taking into account the regulatory framework at a Group level;
— ensures that the Bank's liquidity management complies with AIB Group liquidity policy.

*Forms an integral part of the audited financial statements.

Risk management report

3.2 Liquidity risk* *(continued)*
It is the Bank's policy to ensure that resources are at all times available to meet the Bank's obligations. The Bank meets its day to day residual funding requirements through borrowing facilities in place with Allied Irish Banks, p.l.c. and with the Central Bank of Ireland and access to ECB funding. The table on page 43 analyses the liabilities into relevant maturity groupings based on the remaining period at the reporting date to contractual maturity date.

3.3 Operational risk*
Operational risk, which is inherent in all business activities, is the exposure to loss from inadequate or failed internal processes, people and systems, or from external events.

The management of operational risk is a line management responsibility. It is supported by specialist Operational Risk Management ('ORM') functions within Allied Irish Banks, p.l.c. that assist and advise line management on specific operational risks. Examples include business continuity planning, information security and insurance.

An element of AIB Mortgage Bank's ORM programme is an operational risk self-assessment process. This process requires the Bank to assess its operational risks and the effectiveness of the related controls to address these risks. It complements the risk-based audit approach applied by internal audit in its role as independent assessor of management's control and risk management processes.

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

AIB Mortgage Bank's regulatory compliance risk is managed as part of the overall AIB Group Regulatory compliance framework. This includes risk identification and assessment, risk management and mitigation, and risk monitoring and reporting processes.

3.5 Non-trading interest rate risk*
Interest rate risk is the exposure of the Bank's earnings to movements in market interest rates. The Bank is exposed to risk of interest rate fluctuations to the extent that assets and liabilities mature or reprice at different times or in differing amounts.

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.

After taking account of the effect of interest rate swaps, the Bank's remaining interest rate exposure arises mainly from variable interest rate mortgage loans, where the interest rate for the majority of the loans is based on the ECB Refinancing Rate, whereas the related funding cost is based on Euribor rates.

Interest-rate risk arising from the issuance of fixed-rate Mortgage Covered Securities is managed through interest rate swaps with AIB which have the effect of transforming fixed-rate liability risk into floating-rate risk.

The interest rate exposure of the Bank relating to its Irish residential lending is managed using two macro interest rate swaps with Allied Irish Banks, p.l.c. one of which, the Pool Hedge, relates only to the Pool and Mortgage Covered Securities issued by the Bank and the other of which (the Non-Pool Hedge) relates only to Irish residential loans which are not included in the Pool. This split is required by the Asset Covered Securities Acts.

*Forms an integral part of the audited financial statements.

Risk management report

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

Interest rate swaps are used solely for risk management and not trading purposes.

The nominal values of the swaps are set out in note 7, to the financial statements.

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

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

Interest rate sensitivity
The net interest rate sensitivity of AIB Mortgage Bank at 31 December 2012 is illustrated in the following table;

*Forms an integral part of the audited financial statements.

AIB Mortgage Bank

Interest Rate Sensitivity*

Interest Rate Sensitivity analysis for the Bank at 31 December 2012 is as follows:

Assets	**0≤1mth**	**1≤3mths**	**3≤12mths**	**1≤2yrs**	**2≤3yrs**	**3≤4yrs**	**4≤5yrs**	**5yrs+**	**Rate Insensitive**	**Total**
	€ m	**€ m**	**€ m**	**€ m**	**€ m**	**€m**	**€ m**	**€ m**	**€ m**	**€ m**
Loans and receivables to customers	17,295	286	824	642	401	204	32	56	2,008	21,748
Loans and receivables to bank	498	–	–	–	–	–	–	–		498
Derivatives and other financial instruments	–	–	–	–	–	–	–	–	421	421
Other Assets	–	–	–	–	–	–	–	–	245	245
Total Assets	**17,793**	**286**	**824**	**642**	**401**	**204**	**32**	**56**	**2,674**	**22,912**
Liabilities										
Deposits by banks	16,923	–	–	–	–	–	–	–	–	16,923
Derivatives and other financial instruments	–	–	–	–	–	–	–	–	72	72
Debt issued	1,000	–	1,000	–	500	–	1,675	90	353	4,618
Subordinated liabilities	300	–	–	–	–	–	–	–	–	300
Other liabilities	–	–	–	–	–	–	–	–	75	75
Shareholders' equity	–	–	–	–	–	–	–	–	924	924
Total Liabilities	**18,223**	**–**	**1,000**	**–**	**500**	**–**	**1,675**	**90**	**1,424**	**22,912**
Derivatives financial instruments (interest rate swaps)										
Floating rate interest receivable	23,900	–	–	–	–	–	–	–	–	23,900
Floating rate interest payable	(21,455)	(286)	(824)	(642)	(401)	(204)	(32)	(56)	–	(23,900)
Floating rate interest payable	(3,265)	–	–	–	–	–	–	–	–	(3,265)
Fixed rate interest receivable	–	–	1,000	–	500		1,675	90	–	3,265
Total derivatives	**(820)**	**(286)**	**176**	**(642)**	**99**	**(204)**	**1,643**	**34**	**–**	**–**
Interest sensitivity gap	**(1,250)**	**–**	**–**	**–**	**–**	**–**	**–**	**–**	**1,250**	**–**
Cumulative interest sensitivity gap	**(1,250)**	**(1,250)**	**(1,250)**	**(1,250)**	**(1,250)**	**(1,250)**	**(1,250)**	**(1,250)**	**–**	**–**

*Forms an integral part of the audited financial statements.

AIB Mortgage Bank

Interest Rate Sensitivity*
Interest Rate Sensitivity analysis for the Bank at 31 December 2011 is as follows:

Assets	**0≤1mth**	**1≤3mths**	**3≤12mths**	**1≤2yrs**	**2≤3yrs**	**3≤4yrs**	**4≤5yrs**	**5yrs+**	**Rate Insensitive**	**Total**
	€ m	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€ m**	**€m**	**€ m**	**€m**
Loans and receivables to customers	17,517	187	792	1,118	636	349	215	73	1,557	22,444
Loans and receivables to banks	666	–	–	–	–	–	–	–	–	666
Derivatices and other financial instruments	–	–	–	–	–	–	–	–	409	409
Other Assets	–	–	–	–	–	–	–	–	213	213
Total Assets	**18,183**	**187**	**792**	**1,118**	**636**	**349**	**215**	**73**	**2,179**	**23,732**
Liabilities										
Deposits by banks	15,960	–	–	–	–	–	–	–	–	15,960
Derivatives and other financial instruments	–	–	–	–	–	–	–	–	22	22
Debt issued	3,250	–	–	1,000	–	–	–	1,765	343	6,358
Subordinated liabilities	300	–	–	–	–	–	–	–	–	300
Other liabilities	–	–	–	–	–	–	–	–	71	71
Shareholders's equity	–	–	–	–	–	–	–	–	1,021	1,021
Total liabilities	**19,510**	**–**	**–**	**1,000**	**–**	**–**	**–**	**1,765**	**1,457**	**23,732**
Derivatives financial instruments (interest rate swaps)										
Floating rate interest receivable	24,067	–	–	–	–	–	–	–	–	24,067
Floating rate interest payable	(20,697)	(187)	(792)	(1,118)	(636)	(349)	(215)	(73)	–	(24,067)
Floating rate interest payable	(2,765)	–	–	–	–	–	–	–	–	(2,765)
Fixed rate interest receivable	–	–	–	1,000	–	–	–	1,765	–	2,765
Total derivatives	**605**	**(187)**	**(792)**	**(118)**	**(636)**	**(349)**	**(215)**	**1,692**	**–**	**–**
Interest sensitivity gap	**(722)**	–	–	–	–	–	–	–	**722**	–
Cumulative interest sensitivity gap	**(722)**	**(722)**	**(722)**	**(722)**	**(722)**	**(722)**	**(722)**	**(722)**	–	–

*Forms an integral part of the audited financial statements.

Risk management report

Financial liabilities by contractual maturity*

2012	Repayable on demand € m	3 months or less but not repayable on demand € m	1 year or less but over 3 months € m	5 years or less but over 1 year € m	Over 5 years € m	Total € m
Deposits by Banks	**11,918**	**5,005**	**–**	**–**	**–**	**16,923**
Derivative financial instruments	**68**	**–**	**–**	**–**	**4**	**72**
Debt securities in issue	–	–	**2,012**	**2,498**	**108**	**4,618**
Accruals and deferred income	**2**	**4**	**69**		**–**	**75**
Subordinated liabilities	–	–			**300**	**300**
Total	**11,988**	**5,009**	**2,081**	**2,498**	**412**	**21,988**
Commitments	–	–	**230**	**–**	**–**	**230**

2011	Repayable on demand € m	3 months or less but not repayable on demand € m	1 year or less but over 3 months € m	5 years or less but over 1 year € m	Over 5 years € m	Total € m
Deposits by Banks	11,623	4,337	–	–	–	15,960
Derivative financial instruments	19	–	–	–	3	22
Debt securities in issue	–	–	2,250	2,039	2,069	6,358
Other liabilities	–	–	–	–	–	–
Accruals and deferred income	–	3	68	–	–	71
Subordinated liabilities	–	–	–	–	300	300
Total	11,642	4,340	2,318	2,039	2,372	22,711
Commitments	–	–	239	–	–	239

*Forms an integral part of the audited financial statements.

Independent Auditor's Report

Independent Auditor's Report to the Members of AIB Mortgage Bank

We have audited the financial statements ("financial statements") of AIB Mortgage Bank (the "Company") for the year ended 31 December 2012 which comprise the income statement, the statement of comprehensive income, the statement of financial position, the statement of cash flows, the statement of changes in equity and the related notes. The financial reporting framework that has been applied in their preparation is Irish law and International Financial Reporting Standards ("IFRSs") as adopted by the European Union and as applied in accordance with the provisions of the Companies Acts 1963 to 2012.

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

Respective responsibilities of directors and auditors

As explained more fully in the Directors' Responsibilities Statement set out on page 11. the directors are responsible for the preparation of the financial statements giving a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with Irish law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Ethical Standards for Auditors issued by the Auditing Practices Board.

Scope of the audit of the financial statements

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

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU and as applied in accordance with the provisions of the Companies Acts 1963 to 2012 of the state of the Company's affairs as at 31 December 2012 and of its loss for the year then ended; and
- the financial statements have been properly prepared in accordance with the Companies Acts, 1963 to 2012.

Matters on which we are required to report by the Companies Acts, 1963 to 2012

We have obtained all the information and explanations which we consider necessary for the purposes of our audit.
The statement of financial position is in agreement with the books of account and, in our opinion, proper books of account have been kept by the Company.

In our opinion the information given in the directors' report is consistent with the financial statements.

Independent Auditor's Report

Independent Auditor's Report to the Members of AIB Mortgage Bank

Opinion *(continued)*

The net assets of the Company, as stated in the statement of financial position, are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2012 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the Company.

Matters on which we are required to report by exception

We have nothing to report in respect of the following:

Under the Companies Acts, 1963 to 2012 we are required to report to you if, in our opinion, the disclosures of directors' remuneration and transactions specified by law are not made.

Sean O'Keefe
For and on behalf of
KPMG
Chartered Accountants, Statutory Audit Firm
1 Harbourmaster Place International Financial Services Centre
Dublin 1
Ireland

26 March 2013

Accounting policies

The accounting policies applied in the preparation of the financial statements for the year ended 31 December 2012 are set out below.

1. Reporting entity
AIB Mortgage Bank ('the Bank') is a public unlimited company operating under the Irish Central Bank Act, 1971 (as amended) and as a designated mortgage credit institution under the Asset Covered Securities Acts 2001 and 2007. It is a wholly owned subsidiary of Allied Irish Banks, p.l.c. and is regulated by the Central Bank of Ireland. Its principal purpose is to issue Mortgage Covered Securities for the purpose of financing loans secured on residential property in accordance with the Asset Covered Securities Acts. Such loans may be made directly by the Bank to customers through the AIB Group branch network in the Republic of Ireland or may be purchased from Allied Irish Banks, p.l.c. and other members of the AIB Group or third parties.

2. Statement of compliance
The financial statements have been prepared in accordance with International Accounting Standards and International Financial Reporting Standards (collectively 'IFRS') as issued by the International Accounting Standards Board ("IASB") and subsequently adopted by the European Union ("EU") and applicable for the year ended 31 December 2012. The accounting policies have been consistently applied by the Bank and are consistent with the previous year, unless otherwise described. The financial statements also comply with the requirements of Irish Statute comprising the Companies Acts 1963 to 2012, the Asset Covered Securities Acts 2001 and 2007 and the European Communities (Credit Institutions: Accounts) Regulations, 1992.

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

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

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

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 judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The estimates that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of loan impairment; the reoverability of deferred tax and determination of the fair value of certain financial instruments. A description of these estimates and judgements is set out in section 16 of the accounting policies.

Going concern
The financial statements have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the foreseeable future. The Bank is dependent on its parent Allied Irish Bank p.l.c. for continued funding and is therefore dependent on the going concern of the parent.

Accounting Policies

3. Basis of preparation *(continued)*
Going concern *(continued)*

In making its assessment, the Directors of AIB have considered a wide range of information relating to present and future conditions. These have included financial plans, cash flow and funding forecasts, capital resources projections, all of which have been prepared under base and stress scenarios. In addition, the Directors of AIB have considered the commitment of support provided to AIB by the Irish Government, through the programme for restructuring the Irish banking system, with AIB designated as one of the two 'Pillar Banks'. Furthermore, the Directors have considered the outlook for the Irish economy, taking into account such factors as progress on improving the fiscal situation and the support provided by the EU/IMF to Ireland and the fact that the economy returned to a modest growth path in 2011-2012. The Directors of AIB also considered the eurozone sovereign debt crisis taking into account the developments taken at an EU level that lead to a marked easing of the crisis and improvement of conditions in eurozone financial markets during the second half of 2012.

Capital
In March 2011, following the Financial Measures Programme (FMP) the Central Bank announced new minimum capital target ratios for AIB of 10.5% core tier 1 capital, in a base scenario and 6% core tier 1 capital in a stressed scenario. These target ratios form the basis of the AIB Group's capital management policy and are the capital adequacy requirements effective as at 31 December 2012. The AIB Group's core tier 1 ratio at 31 December 2012 is 15.8% (2011: 17.9%). The AIB Group's total capital ratio at 31 December 2012 is 18.3% (2011: 20.5%).

In October 2012, AIB published the results of the final assessment of the December 2011 capital exercise co-ordinated by the European Banking Authority (EBA) under the supervision of the Central Bank of Ireland (CBI). The published results confirmed that as at June 2012, AIB met the 9% core tier 1 ratio including the sovereign buffer as stated in the EBA December 2011 recommendation.

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

The Directors of AIB have reviewed the capital and financial plans for the period of assessment, and although AIB consumes capital over the life of the plan they believe that the capital resources are sufficient to ensure that the Group is adequately capitalised both in a base and stress scenario.

Liquidity and funding
Customer deposits at 55% (up from 47% at 31 December 2011) are the single most important element of the AIB Group's funding mix. Customer deposit accounts have increased by €3 billion in the full year 2012, which takes account of the run-off of Offshore deposits of €2 billion over the same period. Growth was experienced across all business areas during this period, as sentiment towards Ireland and Irish banks improved. During this period Allied Irish Bank (GB) and First Trust Bank in Northern Ireland withdrew from the Eligible Liabilities Guarantee scheme. This is consistent with the Group's objective to ultimately operate without the guarantee.

Wholesale funding markets continued to be challenging in 2012, however, it was a year of 'two halves', with significant improvement in sentiment towards Ireland in the second half of 2012. During this period, AIBMB re-entered the wholesale markets, by issuing a covered bond in November 2012. AIBMB also issued a second covered bond in January 2013.

Accounting Policies

3. Basis of preparation *(continued)*
Liquidity and funding *(continued)*
The key factors influencing the AIB Group's capacity for asset growth and its future shape will be:
- – The performance of the economy;
- – Retention and gathering of stable customer accounts in a challenging and increasingly competitive market environment;
- – Gaining access to unsecured wholesale term markets; and
- – Action to deleverage non-core assets.

The above are paramount to increasing the AIB Group's pool of available liquid assets and to the AIB Group's overall funding/liquidity strategy.

The AIB Group continues to remain dependent on Central Bank/ECB support. However, 2012 saw a significant reduction in this source of funding. Central Bank/ECB support amounted to €22 billion at 31 December 2012, down from €31 billion at 31 December 2011. This was due to asset deleveraging, loan amortisation and continued weak demand for credit, the redemption of NAMA senior bonds and increased deposits, partially offsest by maturing secured and unsecured bonds (Covered Bonds and Medium Term Notes ('MTN') respectively). In addition, AIB ceased issuance of its Own Use Bank Bonds (i.e. self-issued MTN under the Government guarantee) in the first half of 2012.

Notwithstanding improvements in 2012, it is expected that the AIB Group will continue to be reliant on the monetary authorities for funding during the assessment period. However, AIB's continued access to Central Bank funding support as required is considered to be assured due to its position as one of the two 'Pillar Banks'.

The Directors are satisfied based on the AIB's position as one of the two 'Pillar Banks' that in all reasonable circumstances, the required liquidity and funding from the Central Bank/ECB will be available to the Group during the period of assessment. The Directors, therefore consider that the funding and liquidity position of AIB is assured during the assessment period.

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

On the basis of the continued availability of funding from AIB, the Directors of AIBMB consider that it is appropriate to prepare the financial statements on a going concern basis at this time.

Adoption of new accounting standards
The following amendments to standards have been adopted by the Bank during the year ended 31 December 2012:

<u>Disclosures – Transfers of Financial Assets (Amendments to IFRS 7)</u>
This amendment to IFRS 7 requires certain disclosures in respect of all transferred financial assets that are not derecognised in their entirety and transferred assets that are derecognised in their entirety but with which there is continuing involvement including the possible effects of any risks that may remain with the transferor of the assets. This amendment had no impact on these financial statements.

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

The effective interest method is a method of calculating the amortised cost of a financial asset or financial liability (or group of assets and liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument,

Accounting Policies

4. Interest income and expense recognition *(continued)*
or when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. The application of the method has the effect of recognising income (and expense) receivable (or payable) on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.In calculating the effective interest rate, the Bank estimates cash flows (using projections based on its experience of customers' behaviour) considering all contractual terms of the financial instrument but excluding future credit losses.

The calculation takes into account all fees, including those for any expected early redemption, and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts.

All costs associated with mortgage incentive schemes including reduced introductory rates and 'cash back' incentives are included in the effective interest calculation.

5. Fee and commission income
Fees and commissions are generally recognised on an accruals basis when the service has been provided unless included in the effective interest rate calculation.

6. 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.

7. Financial assets
Loans and receivables
Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale.

They arise when the Bank provides money or services directly to a customer with no intention of trading the loan. Loans are recognised when cash is advanced to the borrowers. Financial assets are initially recognised at fair value adjusted for direct and incremental transaction costs and are subsequently carried on an amortised cost basis. Financial assets are derecognised when rights to receive cash flows from financial assets have expired or when the Bank has transferred substantially all the risks and rewards of ownership.

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

Financial liabilities are initially recognised at fair value, being the issue proceeds (fair value of consideration received) net of transaction costs incurred. Financial liabilities are subsequently measured at amortised cost and any difference between the proceeds net of transaction costs and the redemption value is recognised in the income statement using the effective interest rate method. The Bank derecognises a financial liability when its contractual obligation is discharged, cancelled or expired. Any gain or loss on the extinguishment or remeasurement of a financial liability is recognised in profit or loss. Refer to derivatives and hedge accounting, set out within item 9 of this section, for the accounting policy for financial liabilities in a hedge accounting relationship.

9. Derivatives and hedge accounting
Derivatives, such as interest rate swaps, are used only for risk management purposes.

Accounting policies

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

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

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

Hedging
All derivatives are carried at fair value in the Statement of Financial Position 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 when transactions meet the criteria specified in IAS 39 "Financial Instruments: Recognition and Measurement", the Bank designates certain derivatives as hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge).

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

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

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

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

Accounting Policies

9. Derivatives and hedge accounting*(continued)*

Derivatives that do not qualify for hedge accounting

Certain derivative contracts entered into as economic hedges do not qualify for hedge accounting. Changes to the fair value of derivative instruments that do not qualify for hedge accounting 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.

10. Non-current assets held for sale

A non-current asset or a group of assets containing a non-current asset (a disposal group) is classified as held for sale if 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, non-current assets and disposal groups are measured at the lower of their 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 remeasurement. However, financial assets within the scope of IAS 39 continue to be measured in accordance with that standard. No reclassifications are made in respect of prior periods.

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

11. Impairment of financial assets

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

Impairment

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

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

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

Accounting Policies

11. Impairment of financial assets *(continued)*

Incurred but not reported

The Bank first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (i.e. individually insignificant). If the Bank determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and includes these performing assets under the collective incurred but not reported ('IBNR') assessment. An IBNR impairment provision represents an interim step pending the identification of impairment losses on an individual asset in a group of financial assets. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be, recognised are not included in a collective assessment of impairment.

Collective evaluation of impairment

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

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and the historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

The methodology and assumption used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.

Impairment loss

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

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

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

Past due loans

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

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

Accounting Policies

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

Forbearance
A forbearance agreement is entered into where the customer is in financial difficulty to the extent that they are unable to repay both the principal and interest on their loan in accordance with their original contract. Following an assessment of the customer's repayment capacity, a potential solution will be determined from the options available. A request for a forbearance solution acts as a trigger for an impairment test under IAS 39 as it may confirm that a loss event has occurred. There are a number of different types of forbearance options including interest and/or arrears capitalisation, interest rate adjustments, payment holidays, term extensions and equity swaps. A request for a forbearance solution acts as a trigger for an impairment test under IAS 39 as it may confirm that a loss event has occurred.

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

Forbearance mortgage loans, classified as impaired, may be upgraded from impaired status, subject to a satisfactory assessment by the appropriate credit authority as to the borrower's continuing ability and willingness to repay and confirmation that the relevant security held by the Bank continues to be enforceable. In this regard, the borrower is required to display a satisfactory performance following the period of restructure of the loan, comprising a period of six months consecutive payments of full principal and interest and typically, the upgrade would initially be to Watch/Vulnerable grades. If a loan is upgraded from impaired, it will be included in the Bank's collective assessment for IBNR provisions.

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

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

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

Accounting Policies

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

12. Employee benefits
Retirement benefit obligations
The Bank, through its parent Allied Irish Bank p.l.c. provides employees with post retirement benefits mainly in the form of pensions. It is AIB Group policy to provide for pension and other post-retirement benefits at rates recommended by independent actuaries. Staff members of the Bank are members of the defined benefit or defined contribution schemes administered by Allied Irish Banks, p.l.c.

AIB's defined benefit scheme was closed to new members from December 1997. Employees who joined AIB since December 1997 joined on a defined contribution basis. In December 2007, the AIB Group introduced a hybrid pension arrangement for employees in the Republic of Ireland who are not members of the defined benefit scheme. This arrangement includes elements of both a defined benefit and a defined contribution scheme. It is not possible to identify the Bank's share of the underlying assets and liabilities of the main scheme. Consequently the Bank's proportionate share of the cost of the main scheme is accounted for as a defined contribution scheme. The standard contribution rate in Ireland was 8% for 2007 and increased to 10% in respect of the defined contribution elements of the hybrid arrangement.

Termination benefits
Termination benefits are recognised as an expense when the Bank is demonstrably committed, without the realistic possibility of withdrawal, to a formal plan to terminate employment before the normal retirement date. Termination benefits for voluntary redundancies are recognised if the Bank has made an offer seeking applications for voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably.

13. 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.

14. Income tax, including deferred tax
Income tax comprises current and deferred tax. Income tax is recognised in the Income Statement. Current tax is the expected tax payable on the taxable income for the year using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous years.

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

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.

Accounting policies

15. Cash and cash equivalents
For the purposes of the statement of cashflows, cash comprises cash on hand and demand deposits and cash equivalents comprise highly liquid investments that are convertible into cash with an insignificant risk of changes in value and with original maturities of less than three months.

16. Accounting estimates and judgements
The estimates that have a significant impact on the financial statements and estimates with a significant risk of material adjustment in the next year are set out below:

(a) Loan impairment
AIB's accounting policy for impairment of financial assets is set out in accounting policy number 11. The provisions for impairment on loans and receivables at 31 December 2012 represent management's best estimate of the losses incurred in the loan portfolios at the reporting date.

The estimation of loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local and international economic climates, conditions in various industries to which the Bank is exposed and other external factors such as legal and regulatory requirements.

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

The management process for the identification of loans requiring provision is underpinned by independent tiers of review. Credit quality and loan loss provisioning are independently monitored by credit and risk management on a regular basis. The Bank assesses and approves its provisions and provision adequacy on a quarterly basis. These provisions are in turn reviewed and approved by the AIB Group Credit Committee on a quarterly basis with ultimate Group levels being approved by the Audit Committee and the Board.

Key assumptions underpinning the Bank's estimates of collective and IBNR provisioning are back tested with the benefit of experience and revisited for currency on a regular basis.

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

The amount of an individually assessed specific provision required is highly dependant on estimates of the amount of future cash flows and their timing. Individually insignificant loans are collectively evaluated for impairment. As this process is model driven, based on historic loan recovery rates, the total amount of the Bank's impairment provisions on these loans is somewhat uncertain as it may not totally reflect the impact of the prevailing market conditions. However, the recovery rates are updated at a minimum on a yearly basis.

Changes in the estimate of the value of security and the time it takes to receive those cash flows could have a significant effect on the amount of impairment provisions required and on the income statement expense and balance sheet position. In assessing the value of residential property held as collateral for impaired mortgage loans in Ireland, AIB uses a 'peak to trough' house price decline of 55% as a base. In certain circumstances, realisation costs of 10% to 20% are also deducted. For larger impaired loans (individually significant) other factors such as recent transactional evidence and/or local knowledge are considered, which can result in higher discounts to collateral values. CSO statistics for December 2012 outline a 'peak to trough' decline of 49.6% for

Accounting policies

16. Accounting estimates and judgements *(continued)*
Loan impairment *(continued)*
residential property nationally. If prices were to decline by a further 5% from AIB's assumed values and this decline fell directly through to the collateral values of its impaired mortgage loans in Ireland, the additional impairment provision impact would be in the range of approximately €130 million to €150 million.

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

The total amount of impairment loss in the Bank's non-impaired portfolio and therefore the adequacy of the IBNR allowance is inherently uncertain. There may be factors in the portfolio that have not been a feature of the past and changes in credit grading profiles and grading movements may lag the change in the credit profile of the customer. In addition, current estimates of loss within the earning portfolio and the period of time that it takes following a loss event for an individual loan to be recognised as impaired ('emergence period') are subject to a greater element of estimation due to unprecedented market conditions.

Forbearance
The Bank through AIB has developed a number of forbearance strategies for both short-term and longer–term solutions to assist customers experiencing financial difficulties. The forbearance strategies involve modifications to contractual repayment terms in order to improve the collectability of outstanding debt, to avoid default, and where relevant, to avoid repossessions. The longer-term advanced forbearance strategies are currently in the process of being rolled out to relevant residential mortgage customers in Ireland, accordingly, a higher level of judgement and estimation is involved in determining their effects on impairment provisions.

(b) Deferred tax
Deferred tax assets are recognised for unused tax losses to the extent that it is probable (defined for this purpose as more likely than not) that there will be sufficient future taxable profits against which the losses can be used. For a company with a history of recent losses, there must be convincing other evidence to underpin this assessment. The recognition of the deferred tax asset relies on the assessment of future profitability and the sufficiency of those profits to absorb losses carried forward. It requires significant judgements to be made about the projection of long-term future profitability because of the period over which recovery extends.

In assessing the future profitability of the Bank, the Board has considered a range of positive and negative evidence for this purpose. Among this evidence, the principal positive factors include the:

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

Taking account of all relevant factors, the Bank believes that it is more likely than not that it will return to profitability within the timescale of the Bank's financial plan by 2014 and will achieve profits producing a sustainable market-range return on equity in the long term. In the absence of any expiry date for tax losses in Ireland, the Bank therefore believes that it is more likely than not that there will be future profits against which to use the tax losses.

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

Accounting policies

16. Accounting estimates and judgements *(continued)*

(c) Fair value of financial instruments

The fair value of a financial instrument is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction. Financial assets are initially recognised at fair value and, with the exception of financial assets at fair value through profit or loss, the initial fair value includes direct and incremental transaction costs. Financial liabilities are initially recognised at fair value, being their issue proceeds (fair value of consideration received) net of transaction costs incurred. 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 on an arm's length basis. Where quoted prices are not available or are unreliable because of market inactivity, fair values are determined using valuation techniques. These valuation techniques which use, to the extent possible, observable market data, include the use of recent arm's length transactions, reference to other similar instruments, option pricing models and discounted cash flow analysis and other valuation techniques commonly used by market participants.

17. Share capital

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

18. Contingent liabilities and assets

A contingent liability is a present obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or a present obligation that arises from past events but is not recognised because it is not probable that an outflow of resources will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability.
The Bank discloses contingent liabilities and assets in accordance with IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

19. Business combination

The Bank accounts for the acquisition of businesses using the acquisition method except for those businesses under common control. The consideration transferred in a business combination is measured at fair value, which is calculated as the sum of the acquisition date fair value of assets transferred by the Bank, liabilities incurred by the Bank to the former owners of the acquiree, and the equity interests issued by the Bank in exchange for control of the acquiree. Acquisition related costs are generally recognised in the income statement as incurred. Goodwill is measured as the excess of the sum of the consideration transferred, the amount of any non-controlling interests in the acquiree, and the fair value of the acquirer's previously held equity interest in the acquiree, if any, over the net of the acquisition date fair value of the identifiable assets acquired and liabilities assumed.

It is Bank policy to account for the acquisition between entities under common control at carrying value at the date of the transaction. As a result acquisitions of businesses between members of the AIB Group are measured at their carrying value at the date of the transaction, except where prohibited by company law or IFRS.

20. Prospective accounting changes

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

Accounting Policies

20. Prospective accounting changes *(continued)*
The following will be applied in 2013 unless otherwise noted
Amendments to IAS 1 - Presentation of Items in Other Comprehensive Income
The amendments to IAS 1 were issued in June 2011 and are applicable to annual periods beginning on or after 1 July 2012. These amendments require companies preparing financial statements in accordance with IFRSs to group together items within other comprehensive income that may be reclassified to the profit or loss section of the income statement. The amendments also reaffirm existing requirements that items in other comprehensive income and profit or loss should be presented as either a single statement or two consecutive statements.

IFRS 13 Fair Value Measurement
This standard, which applies prospectively for annual periods beginning on or after 1 January 2013, establishes a single source of guidance for fair value measurements under IFRSs. IFRS 13 defines fair value, provides guidance on its determination and introduces consistent requirements for disclosures on fair value measurements. IFRS 13 requires entities to disclose information about the valuation techniques and inputs used to measure fair value, as well as information about the uncertainty inherent in fair value measurements. This information will be required for both financial and non-financial assets and liabilities. Whilst the impact of the standard will not have a significant impact on reported results or the financial position of the Bank, there will be a requirement for additional disclosures.

Offsetting Financial Assets and Financial Liabilities – Amendments to IAS 32, and Disclosures
Offsetting Financial Assets and Financial Liabilities – Amendments to IFRS 7
The amendments to IAS 32 and IFRS 7 clarify the accounting requirements for offsetting financial instruments and introduce new disclosure requirements that aim to improve the comparability of financial statements prepared in accordance with IFRS and US GAAP.

The amendments to IFRS 7 will require more extensive disclosures than are currently required. The disclosures focus on quantitative information about recognised financial instruments that are offset in the statement of financial position, as well as those recognised financial instruments that are subject to master netting or similar arrangements, irrespective of whether they are offset. The amended offsetting disclosures are to be retrospectively applied, with an effective date of annual periods beginning on or after 1 January 2013.

The amendments to IAS 32 clarify that in order to offset financial instruments the right of set-off must be currently available and legally enforceable for all counterparties in the normal course of business, as well as in the event of default, insolvency or bankruptcy. The IAS 32 changes are effective for annual periods beginning on or after 1 January 2014 and apply retrospectively.

The following will be applied in 2015 if EU adopted:

IFRS 9 Financial instruments
IFRS 9 will ultimately replace IAS 39 Financial Instruments: Recognition and Measurement. This project consists of three main phases:

Phase1: Classification and measurement
In November 2009, the IASB issued IFRS 9 *Financial Instruments* covering classification and measurement of financial assets. The new standard aims to enhance the ability of investors and other users of financial information to understand the accounting for financial assets and to reduce complexity. IFRS 9 uses a single approach to determine whether a financial asset is measured at amortised cost or fair value. The basis of classification depends on how an entity manages its financial instruments (its business model) and the contractual cash flow characteristics of the financial assets.

Accounting Policies

20. Prospective accounting changes *(continued)*

IFRS 9 Financial Instruments *(continued)*
The IASB reissued IFRS 9 in October 2010. The revised standard carried over the requirements for derecognition of financial assets and liabilities from IAS 39 and incorporated new requirements on accounting for financial liabilities. Where an entity designates a financial liability on initial recognition at fair value through profit or loss, the portion of the fair value change due to changes in the liability's credit risk is recognised directly in other comprehensive income. The remainder is recognised in profit and loss.

Phase 2: Impairment methodology
The IASB published an exposure draft in November 2009 that proposed an 'expected loss model' for impairment. This phase of IFRS 9 is subject to ongoing deliberations and has not yet been finalised.

Phase 3: Hedge accounting
In September 2012, the IASB posted on its website a review draft of the proposed micro hedge accounting requirements that will be incorporated into IFRS 9. The draft proposes a model that aims to align hedge accounting with risk management activities; establishes a more principles-based approach to hedge accounting; and addresses inconsistencies and weaknesses in the existing model in IAS 39. This phase is expected to be finalised in the first quarter of 2013. At a later point, further proposals will be issued by the IASB on macro hedging.

Since significant aspects of the standard have yet to be finalised, it is impracticable for the Bank to quantify the impact of IFRS 9 at this stage.

The new standard will be subject to EU endorsement.

Income statement
for the year ended 31 December 2012

	Notes	2012	2011
		€m	€m
Interest and similar income	1	**694**	774
Interest expense and similar charges	2	**(480)**	(630)
Net interest income		**214**	144
Other operating income	3	**4**	22
Total operating income		**218**	166
Administrative expenses	4	**(63)**	(43)
Operating profit before provisions		**155**	123
Provisions for impairment of loans and receivables	5	**(494)**	(1,034)
Operating (loss) before taxation		**(339)**	(911)
Taxation on ordinary activities	6	**42**	114
(Loss) for the year		**(297)**	(797)

The operating loss arises from continuing operations.

The notes on pages 65 to 83 are an integral part of these financial statements.

Director: Dave Keenan *Director:* Jim O'Keeffe

Director: Ivor Larkin *Secretary:* David Schorman

Date: *26 M*arch 2013

Statement of comprehensive income
for the year ended 31 December 2012

	2012	2011
	€ m	€ m
(Loss) for the year	**(297)**	(797)
Other comprehensive income	–	–
Total comprehensive income for the year	**(297)**	(797)

Statement of financial position

as at 31 December 2012

	Notes	2012 €m	2011 €m
Assets			
Derivative financial instruments	7	**421**	409
Loans and receivables to banks	8	**498**	666
Loans and receivables to customers	9	**21,748**	22,444
Other assets	10	**50**	62
Deferred taxation	11	**195**	151
Total assets		**22,912**	23,732
Liabilities			
Deposits by banks	12	**16,923**	15,960
Derivative financial instruments	7	**72**	22
Debt securities issue	13	**4,618**	6,358
Accruals and deferred income	14	**75**	71
Subordinated liabilities	15	**300**	300
Total liabilities		**21,988**	22,711
Shareholders' equity			
Share Capital	16	**1,545**	1,345
Capital reserves	17	**580**	580
Profit and loss account		**(1,201)**	(904)
Total shareholders' equity		**924**	1,021
Total liabilities and shareholders' equity		**22,912**	23,732

Director: Dave Keenan

Director: Jim O'Keeffe

Director: Ivor Larkin

Secretary: David Schorman

Date: *26* March 2013

Statement of cash flows

for the year ended 31 December 2012

	Notes	2012 € m	2011 € m
Reconciliation of loss before taxation to net cash outflow from operation activities			
(Loss) before taxation		**(339)**	(911)
(Increase) in prepayments and accrued income		**–**	(37)
(Decrease) in other provisions		**–**	(44)
Increase/(decrease) in accruals and deferred income		**4**	(1)
Provisions for impairment of loans and receivables		**494**	1,034
		159	41
Net decrease in assets held for sale		**–**	78
Net (decrease) in debt securities in issue		**(1,740)**	(2,449)
Net increase/(decrease) in derivative financial instruments		**38**	(51)
Net decrease in loans and receivables to banks		**–**	15,671
Net increase/(decrease) in deposits by banks		**963**	(15,693)
Net decrease/(increase) in other assets		**12**	(1)
Net decrease in loans and receivables to customers		**202**	835
Net cash outflow from operating assets and liabilities		**(525)**	(1,610)
Net cash outflow from operating activities before taxation		**(366)**	(1,569)
Taxation paid		**(2)**	–
Net cash outflow from operating activities		**(368)**	(1,569)
Net cashflow from investing activities			
Acquisition of loans & receivables from AIB p.l.c.	20	**–**	(4,234)
Net cash inflow from financing activities			
Proceeds from issue of ordinary shares		**200**	895
Increase in capital reserves		**–**	500
Increase in deposits by banks		**–**	4,234
Net cashflow from financing activities		**200**	5,629
(Decrease) in cash and cash equivalents		**(168)**	(174)
Opening cash and cash equivalents		**666**	840
Closing cash and cash equivalents	20	**498**	666

Statement of changes in equity

for the year ended 31 December 2012

	Share Capital € m	Capital Reserves € m	Profit and Loss Account € m	Total € m
Balance at 1 January 2012	**1,345**	**580**	**(904)**	**1,021**
Loss attributable to equity holders	**–**	**–**	**(297)**	**(297)**
Share capital issued	**200**	**–**	**–**	**200**
Balance at 31 December 2012	**1,545**	**580**	**(1,201)**	**924**
Balance at 1 January 2011	450	80	(107)	423
Loss attributable to equity holders	–	–	(797)	(797)
Share capital issued	895	–	–	895
Capital contribution received	–	500	–	500
Balance at 31 December 2011	1,345	580	(904)	1,021

Notes to the accounts

1. Interest and similar income	**2012** **€ m**	2011 € m
Interest on loans and receivables to customers	**577**	622
Interest receivable from Allied Irish Banks, p.l.c.	**117**	152
	694	774

Included in the interest receivable from Allied Irish Banks, p.l.c. is €110m (2011: €88m) relating to mortgage covered securities hedges (bond swaps) and €7m (2011: €64m) mainly relating to interest earned on funds placed with Allied Irish Banks, p.l.c.

2. Interest expense and similar charges	**2012** **€ m**	2011 € m
Interest payable to Allied Irish Banks, p.l.c	**341**	436
Interest on debt securities in issue	**139**	181
Interest on amounts due to the Central Bank of Ireland	**–**	13
	480	630

Included in the Interest payable to Allied Irish Banks, p.l.c. is €292m (2011: €398m) relating to interest payable on funding based on one month Euribor, other additional funding costs, and interest payable on mortgage loan portfolio swaps. The interest payable on mortgage loan portfolio swaps amounted to €49m (2011: €38m).

Notes to the accounts

3. Other operating income	2012 € m	2011 € m
Gain on transfer of financial instruments held for sale to NAMA	**4**	22
	4	22

Gain on assets transferred to NAMA

	2012 € m	2011 € m
Carrying value of loans transferred to NAMA (including accrued interest)	–	107
Less impairment provisions (note 5)	–	(6)
Net carrying value of financial instruments transferred	–	101
Fair value of consideration received from NAMA	–	45
Adjustments in respect of assets transferred in prior years	**4**	8
Consideration received	**4**	53
Gain/(loss) on transfer	**4**	(48)
Utilisation of provisions for liabilities & commitments	–	44
Adjustment in respect of assets transferred during 2010	–	26
Gain on transfer of financial instruments held for sale to NAMA	**4**	22

4. Administrative expenses	2012 € m	2011 € m
Personnel expenses*	**1**	–
Other administrative expenses	**4**	4
Amounts payable to Allied Irish Banks, p.l.c. under the outsourcing and Agency Agreement	**58**	39
	63	43

*Retirement benefits of €0.2m are included in personnel expenses in 2012 (2011:€0.1m)

Notes to the accounts

5. Provisions for impairment of loans and receivables

	Specific	**IBNR**	**2012 Total**	Specific	IBNR	2011 Total
	€ m	**€ m**	**€ m**	€ m	€ m	€ m
Balance at start of year	**953**	**604**	**1,557**	160	281	441
Charge/(release) against income statement	**864**	**(370)**	**494**	793	241	1,034
Acquired as part of business combination	**–**	**–**	**–**	24	82	106
Provisions in respect of loans and receivables transferred to NAMA	**–**	**–**	**–**	(6)	–	(6)
Amounts written off	**(43)**	**–**	**(43)**	(18)	–	(18)
At year end	**1,774**	**234**	**2,008**	953	604	1,557

By geographic location and industry sector

	2012 € m	2011 € m
Republic of Ireland		
Home Mortgages	**2,008**	1,557

6. Taxation	**2012 € m**	2011 € m
Current tax prior year adjustment	**2**	(3)
Deferred taxation		
Origination of temporary differences (note 11)	**(44)**	(111)
Total tax	**(42)**	(114)

The tax credit for the year is at an effective rate of 12.5%, which is the same as the standard Irish corporation tax rate.

Notes to the accounts

7. Derivatives and other financial instruments
Set out below are details on fair values and derivative information for AIB Mortgage Bank.

The Bank uses two different types of interest rate swaps to hedge interest rate risk. The first type is used to hedge interest rate risk on mortgage loan accounts both within the Cover Assets Pool and outside the Cover Assets Pool, effectively converting interest receivable from a fixed rate basis to a floating rate basis. Although these swaps are considered to be an effective hedge in economic terms, due to their nature, it has not been possible to establish a "fair value" hedging relationship under IAS 39 with the mortgage loan accounts and consequently, they are classified as "Trading".

The second type of interest rate swaps are vanilla interest rate swaps used to hedge the mortgage covered securities, converting interest payable from a fixed rate basis to a floating rate basis. Effective fair value hedging relationships (as stipulated by IAS 39) have been established between these swaps and the underlying covered bonds and consequently the change in fair value of the swaps is largely offset by fair value movements in the covered bonds themselves.

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

	2012 Contract/ Notional Amount € m	**2012 Fair Value Asset/ (Liability) € m**	2011 Contract/ Notional Amount € m	2011 Fair Value Asset/ (Liability) €m
Derivatives classified as trading				
Hedging mortgage loan accounts - outside the Cover Assets Pool	**6,607**	**(5)**	5,054	(2)
Hedging mortgage loan accounts - within the Cover Assets Pool	**17,293**	**(67)**	19,013	(20)
Total derivatives classified as trading	**23,900**	**(72)**	24,067	(22)
Derivatives classified as hedging (Debt Securities)				
Interest rate swaps	**3,265**	**421**	2,765	409
Total derivatives	**27,165**	**349**	26,832	387

The fair value of derivatives includes net accrued interest of €0.4m (2011:€49m).

The following table represents the underlying principal and gross replacement costs of the Bank's derivatives as at 31 December 2012 and 31 December 2011.

			Residual Maturity 2012				Residual Maturity 2011	
	Within 1yr € m	**1 to 5yrs € m**	**Over 5yrs € m**	**Total € m**	Within 1yr € m	1 to 5 yrs € m	Over 5yrs € m	Total € m
Underlying principal amount								
Interest rate contracts	**24,900**	**2,175**	**90**	**27,165**	24,067	1,000	1,765	26,832
Gross replacement costs								
Interest rate contracts	**37**	**367**	**20**	**424**	–	64	347	411

Notes to the accounts

7. Derivatives and other financial instruments *(continued)*
Fair value of financial instruments
The term "financial instruments" includes financial assets, financial liabilities and derivatives. The fair value of a financial instrument is the amount for which an asset could be exchanged or a liability settled, between knowledgeable, willing parties in an arms length transaction.

Fair value is based upon quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar instruments and adjusted for differences between the quoted instrument and the instrument being valued. In certain cases, including some lending to customers, where there are no ready markets, various techniques have been used to estimate the fair value of the instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and therefore cannot be determined with precision. Readers of these financial statements are advised to use caution when using the data to evaluate the Bank's financial position or to make comparisons with other institutions.

Fair value information is not provided for certain financial instruments or for items that do not meet the definition of a financial instrument. The fair value information presented does not purport to represent, nor should it be construed to represent, the underlying value of the Bank as a going concern at 31 December 2012. For the overall loan portfolio, an adjustment is made for credit risk which at 31 December 2012 took account of the Group's expectation of credit losses over the life of the loans.

The following table gives details of the carrying amounts and fair values of financial instruments.

	2012 Carrying Amount €m	**2012 Fair Value Amount € m**	2011 Carrying Amount € m	2011 Fair Value Amount € m
Assets				
Derivative financial instruments	**421**	**421**	409	409
Loans and receivables to banks	**498**	**498**	666	666
Loans and receivables to customers	**21,748**	**17,938**	22,444	18,137
Liabilities				
Deposits by central banks and banks	**16,923**	**16,923**	15,960	15,960
Derivative financial instruments	**72**	**72**	22	22
Debt securities in issue	**4,618**	**4,370**	6,358	5,261
Subordinated liabilities	**300**	**75**	300	80

The following methods and assumptions were used in estimating the fair value of financial instruments.

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

Loans and receivables to customers
The fair value of variable mortgage products including tracker mortgages is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in the portfolio. For fixed rate loans, the fair value is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in that portfolio. For the overall loan portfolio, an adjustment is made for credit risk which at 31 December 2012 took account of the Bank's forecasted life time impairment losses.

Notes to the accounts

7. Derivatives and other financial instruments *(continued)*

Deposits by banks, customer accounts and debt securities in issue

The fair value of deposits by banks is equal to their book value. The fair value of debt securities in issue is based upon quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar instruments.

Subordinated liabilities

The fair value of the subordinated liabilities was estimated using quoted market prices where available. If a quoted market price is not available, fair value is estimated using quoted market prices for similar instruments. In all cases, redemption prior to maturity is subject to the necessary prior approval of the Central Bank of Ireland.

Derivative financial instruments

The Bank uses various derivatives, designated as hedges, to manage its exposure to fluctuations in interest rates. The fair value of these instruments is estimated using market prices or pricing models consistent with the methods used in AIB Group for valuing similar instruments used for trading purposes.

8. Loans and receivables to banks	**2012** **€ m**	2011 € m
Funds placed with Allied Irish Banks, p.l.c.		
Analysed by remaining maturity:		
- 3 months or less	**463**	566[(1)]
Funds placed with Barclays Bank, p.l.c.		
Analysed by remaining maturity:		
- 3 months or less	**35**	100
	498	666

[(1)] Accrued interest on derivative financial instruments amounting to €68 million has been reclassified to "Derivatives and other financial instruments".

The balances with Allied Irish Banks, p.l.c. include a balance of €463m (2011:€566m) held as collateral for the derivatives. The remaining balances are held with Barclays Bank, p.l.c. and represent the Cash Substitution Pool Assets.

Notes to the accounts

9. Loans and receivables to customers	2012 € m	2011 € m
Analysed by remaining maturity:		
- Repayable on demand	**4,606**	2,737
- 3 months or less	**6**	10
- 1 year or less but over 3 months	**27**	68
- 5 years or less but over 1 year	**388**	388
- Greater than 5 years	**18,729**	20,798
	23,756	24,001
Provisions for impairment of loans and receivables (Note 5)	**(2,008)**	(1,557)
	21,748	22,444

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

The interest on impaired loans provision amounted to €56m (2011: €16m) and is included in the carrying value of loans and receivables to customers. This has been credited to interest income.

By geographic location and sector

Republic of Ireland	2012 € m	2011 € m
Home mortgages (net of provisions)	**21,748**	22,444

10. Other assets	2012 € m	2011 € m
Accrued interest	**30**	28
Recovery due from NAMA	**–**	33
Other assets	**20**	1
	50	62

Notes to the Accounts

11. Deferred taxation	2012 € m	2011 € m
At January	**151**	40
Unutilised tax losses	**44**	111
At 31 December	**195**	151

At 31 December 2012 recognised deferred tax assets on tax losses and other temporary differences, net of deferred tax liabilities, totalled €195m (2011: €151m). The Directors have determined that is more likely than not that these will be recovered. The tax losses arise in the Irish tax jurisdiction and their utilisation is dependent on the generation of future taxable profits. Temporary differences recognised in the income statement consist of provision for impairment of loans and advances.

12. Deposits by central banks and banks	2012 € m	2011 € m
Due to Allied Irish Banks, p.l.c.	**16,923**	15,960[1]

[1]Accrued interest on derivative financial instruments amounting to €19m has been reclassed to "Derivatives and other financial instruments".

The Bank has a borrowing facility with its parent company, Allied Irish Banks, p.l.c., under which the parent company provides the balance of funding after the Bank has availed of other sources of funds.

13. Debt securities in issue	2012 € m	2011 € m
Mortgage covered securities in issue to external investors of €3.62bn (2011: €3.11bn) and in issue to Allied Irish Banks, p.l.c. of €1bn (2011: €3.25bn) held at fair value by remaining maturity:		
- 1 year or less	**2,012**	2,250
- 5 years or less but over 1 year	**2,498**	2,039
- Greater than 5 years	**108**	2,069
	4,618	6,358

	2012 € m	2011 € m
Mortgage covered securities in issue to external investors and internal issuances at nominal value:		
- External investors	**3,265**	2,765
- Allied Irish Banks, p.l.c. *	**1,000**	3,250
- AIB Mortgage Bank **	**6,020**	6,370
	10,285	12,385

Notes to the Accounts

13. Debt securities in issue *(continued)*
Mortgage covered securities issued as self issuances to AIB Mortgage Bank are not recognised in the Statement of Financial Position. As the bearer securities and the mortgage covered securities do not meet the criteria of an asset and a liability under the IASB Framework, no asset or liability has been recognised. The self issuance of securities is however disclosed above. When self issuances of mortgage covered securities are the subject of a sale and repurchase agreement with the ECB by AIB Mortgage Bank, the transaction gives rise to the recognition of an asset and a liability. (See note12).

* As at 31 December 2012 the mortgage covered securities issued to Allied Irish Banks, p.l.c. of €1bn (2011: €3.25bn) were subject to sale and repurchase agreements with the ECB at 31 December 2012, providing liquidity for AIB Group of €0.9bn (2011: €2.61bn).

** As at 31 December 2012 the mortgage covered securities issued to AIB Mortgage Bank of €6.02bn (2011:€6.37bn) were first repoed for value of €5.01bn (2011:€4.34bn) with Allied Irish Banks, p.l.c. and then were subject to a sale and repurchase agreement with the ECB, providing liquidity for AIB Group of €5.01bn (2011:€4.34bn).

AIB Mortgage 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 2012, the Cover Assets Pool amounted to €17.3bn (2011:€19.1bn), comprising of €17.3bn (2011:€19bn) of mortgage credit assets (mortgage loan accounts) and €0.04bn (2011:€0.1bn) of substitution assets (cash on deposit with Barclays Bank, p.l.c). 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.

13 (a) Mortgaged properties and principal loan balances outstanding in the cover assets pool
Total Loan Balances

From	To	**Total Loan Balances 2012 (1 & 2) € m**	**Number of Mortgaged Properties 2012**	Total Loan Balances 2011 (1 & 2) € m	Number of Mortgaged Properties 2011
-	€100,000	**1,975**	**38,534**	1,893	36,945
€100,000	€200,000	**5,537**	**37,506**	5,548	37,411
€200,000	€500,000	**8,085**	**28,721**	9,291	32,702
Over €500,000		**1,702**	**2,220**	2,281	2,910
		17,299	**106,981**	19,013	109,968

(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 122,182 loan accounts (2011:126,840) secured on 106,981 properties (109,968 in 2011).

Notes to the Accounts

13. Debt securities in issue *(continued)*
13 (b) Geographical location of mortgaged properties in the cover assets pool

Geographical Area	**Number of Mortgaged Properties 2012**		Number of Mortgaged Properties 2011	
Co. Dublin	**27,895**	**26%**	27,449	25%
Outside Dublin	**79,086**	**74%**	82,519	75%
	106,981	**100%**	109,968	100%

13(c) Mortgage loan accounts in default in the cover assets pool
As at 31 December 2012, there were no mortgage loan accounts (Nil in 2011) in default in the Cover Assets Pool (in default being defined as mortgage loan accounts credit grade 7 and 8).

13 (d) Mortgage loan accounts in default in the cover assets pool with arrears greater than €1,000
During the year ended 31 December 2012, 182 mortgage loan accounts (2011:160) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2012, there were no accounts in default in the Cover Assets Pool (2011:Nil).

13 (e) Replacement of non-performing mortgage loan accounts from the cover assets pool
During the year ended 31 December 2012, 3,779 non-performing mortgage loan accounts (2011: 2,439) 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.

13 (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 962 accounts (2011:512) as at 31 December 2012 was €908,826 (2011:€415,795). None of the accounts in question were written off as at 31 December 2012, as they were in arrears for less than three months.

13 (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 2012 was €1,689m (2011:€1,855m), of which €1,211m (2011:€1,295m) represented repayment of principal and €478m (2011:€560m) 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.

13 (h) Number and amount of mortgage loans in the cover assets pool secured on commercial property
As at 31 December 2012 there were no loan accounts (2011:Nil) in the Cover Assets Pool that were secured on commercial properties.

Notes to the Accounts

14. Accruals and deferred income	2012 € m	2011 € m
Interest payable on mortgage covered securities	**70**	68
Expenses	**3**	3
Other liabilities	**2**	–
	75	71

15. Subordinated liabilities	2012 € m	2011 € m
Dated Capital Note (a)	**100**	100
Perpetual Capital Note (b)	**200**	200
	300	300

(a) €100,000,000 Dated Subordinated Capital Note – the loan to which this note relates was received from the parent company, Allied Irish Banks, p.l.c. ("AIB") on 13 February 2006. Interest on the amount of principle is calculated on a year of 360 days at a rate of 53 basis points over Euribor payable monthly in arrears. The Note has a fixed maturity date of 12 February 2031. Early repayment may occur at the option of AIB Mortgage Bank with the prior consent of the Central Bank and Financial Services Authority of Ireland (the "Central Bank") on any interest payment date falling any time after five years and one day from the date of issuing the Note.

The loan capital is unsecured and all rights and claims of AIB shall be subordinated to the claims of all creditors who are depositors or other unsubordinated creditors of AIB Mortgage Bank.

(b) €200,000,000 Subordinated Perpetual Capital Note – the loan to which this note relates was received from AIB on 13 February 2006. Interest on the amount of principle is calculated on a year of 360 days at a rate of 100 basis points over Euribor payable monthly in arrears. The Note is undated and has no final maturity date but may be redeemed at the option of AIB Mortgage Bank with the prior consent of the Central Bank at any time after the fifth anniversary of its issue.

The loan capital is unsecured and all rights and claims of AIB shall be subordinated to the claims of all creditors who are depositors or other unsubordinated creditors of AIB Mortgage Bank and creditors of AIB Mortgage Bank whose claims are subordinated to the claims of depositors and other unsubordinated creditors of AIB Mortgage Bank but excluding Pari Passu Subordinated Creditors and those creditors of AIB Mortgage Bank whose claims rank or are expressed to rank junior to the claims of AIB.

16. Share capital	2012 € m	2011 € m
Authorised:		
3,000,000,000 ordinary shares of €1.00 each		
(2011: 3,000,000,000 ordinary shares of €1.00 each)	**3,000**	3,000
Issued and fully paid up:		
1,545,000,000 ordinary shares of €1.00 each		
(2011: 1,345,000,000 ordinary shares of €1.00 each)	**1,545**	1,345
	1,545	1,345

Notes to the accounts

16. Share capital *(continued)*

The 200,000 ordinary shares issued during the year were issued at par. The purpose of the share issue was to ensure that the Bank continued to meet it's regulatory capital requirements. 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.

17. Capital reserves	**2012 € m**	2011 € m
Opening balance	**580**	80
Capital contribution	**–**	500
Closing balance	**580**	580

The Bank received a capital contribution of €500m in October 2011 from its parent Allied Irish Banks, p.l.c. as a result of the capital deficit arising from the loan provisions recorded in the year ended 31 December 2011.

18. Capital Management

The AIB Group policy is to maintain adequate capital resources at all times, having regard to the nature and scale of its business and the risk inherent in its operations. It does this through an Internal Capital Adequacy Assessment Process ("ICAAP"). The overarching principle of the ICAAP is the explicit linkage between capital and risk; the adequacy of the Bank's capital is assessed on the basis of the risks it faces. This requires a clear assessment of the material risk profile of the Bank, and a consideration of the extent to which identified risks, both individually and in aggregate, requires capital to support them.

In addition, the level of capital held by the Bank is influenced by its minimum regulatory requirements.

Capital resources and regulatory capital ratios

The table below shows AIB Mortgage Bank's capital resources as at 31 December 2012 and 31 December 2011.

	Basel II	Basel II
	2012 € m	2011 € m
Shareholders' equity	**924**	1,021
Dated capital notes	**100**	100
Undated capital notes	**200**	200
Total capital resources	**1,224**	1,321

Notes to the accounts

18. Capital Management *(continued)*

The Capital Requirements Directive (CRD) / AIB's implementation of the CRD

The CRD introduces some significant amendments to the existing capital adequacy framework. Its goal is to provide a greater link between the risk a bank faces and the capital it requires and it does this in a number of ways. In terms of minimum capital requirements ('Pillar 1') it brings additional granularity in risk weightings under the foundation internal ratings based approach for credit risk, and introduces an explicit capital requirement for operational risk.

From 1 January 2008, the Bank has calculated its capital requirements under the CRD using the foundation internal ratings based approach.

19. Employee Information

For the year ended 31 December 2012 the average number of employees was 5 (2011: 6). As at 31 December 2012, the Bank had 5 employees.

20. Statement of cash flows	**2012 € m**	2011 € m
Loans and receivables to banks	**498**	666
Cash and cash equivalents	**498**	666

On 25 February 2011, Allied Irish Banks, p.l.c. transferred its mortgage intermediary originated Irish mortgage business to AIB Mortgage Bank pursuant to the statutory transfer mechanism provided for in the Asset Covered Securities Acts. The Irish residential loans transferred by Allied Irish Banks, p.l.c. to AIB Mortgage Bank on 25 February 2011 were approximately €4.2 billion (net of provisions).

21. Auditor's fees	**2012 € '000**	2011 € '000
Statutory audit	**43**	43
Other assurance services	**65**	–
Total auditor's fees	**108**	43

The disclosure of Auditor's fees are in accordance with (SI220)[1] which mandates fees in particular categories and that fees paid to the AIB Mortgage Bank's Auditor (KPMG Ireland) 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.

SI220 is titled the European Communities (Statutory Audits) (Directive 2006/43/EC) Regulations 2010.

Notes to the accounts

22. Director's remuneration	**2012** **€ 000**	2011 € 000
Fees	**25**	52
	25	52

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

24. Contingent liabilities and commitments
At 31 December 2012 the Bank had €230m (2011: €239m) of approved mortgage loan applications that had not been drawn down as at the year end.

25. Summary of the AIB Group relationship with the Irish Government
The Irish Government has taken a range of measures to stabilise the Irish banking system since the commencement of the financial crisis in 2008. These measures have included the injection of equity and preference share capital into AIB. As a result of these capital injections, the Irish Government, through the NPRFC, now holds 99.8% of the ordinary shares of AIB and €3.5 billion in 2009 Preference Shares. In addition, the Minister for Finance holds €1.6 billion of contingent capital notes.

As a result of the various measures taken by the Irish Government (specifically the guarantee schemes, the Direction Order, and the capital injections) the Irish Government is a related party to AIB. Details regarding these measures, as well as others taken in the context of the Irish banking crisis, are set out below. The Minister for Finance ('the Minister') and/or the Central Bank of Ireland has considerable rights and powers over the operations of AIB (and other financial institutions) arising from the various stabilisation measures.
These rights and powers relate to, inter alia:
– The acquisition of shares in other institutions;
– Maintenance of solvency ratios and compliance with any liquidity and capital ratios that the Central Bank, following consultation with the Minister, may direct;
– The appointment of non-executive directors and board changes;
– The appointment of persons to attend meetings of various committees;
– Restructuring of executive management responsibilities, strengthening of management capacity and improvement of governance;
– Declaration and payment of dividends;
– Restrictions on various types of remuneration;
– Buy-backs or redemptions by the Group of its shares;
– The manner in which the Group extends credit to certain customer groups; and
– Conditions regulating the commercial conduct of AIB, having regard to capital ratios, market share and the Group's balance sheet growth.

Details of the measures taken by the Irish Government since 2008:
a) Guarantee schemes
The European Communities (Deposit Guarantee Schemes) Regulations 1995 have been in operation since 1995. These regulations guarantee certain retail deposits up to a maximum of €100,000. In addition, since September 2008, the Irish Government has guaranteed relevant deposits and debt securities of AIB through the Credit Institutions (Financial Support) Scheme 2008 ('the CIFS scheme') which expired in September 2010 and the Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 ("ELG Scheme").

Notes to the accounts

25. Summary of the relationship of AIB Group with the Irish Government *(continued)*
(a) Guarantee Schemes (continued)

ELG Scheme
On 21 January 2010, Allied Irish Banks, p.l.c., including its international branches and subsidiaries, AIB Group (UK) p.l.c., AIB Bank (CI) Limited and Allied Irish Banks North America Inc., became participating institutions for the purposes of the Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 the ('ELG Scheme'). The Minister stands as guarantor of all guaranteed liabilities of a participating institution. The ELG Scheme is intended to facilitate the ability of participating credit institutions in Ireland to issue certain debt securities and take deposits with a maturity of up to five years for pre-defined periods. The original date for periods covered was set at 29 September 2010 and has subsequently been extended a number of times. However, on 26 February 2013, the Minister announced that the ELG scheme will end for all new liabilities, with effect from midnight on 28 March 2013.

Eligible liabilities under the ELG scheme comprise the following:
- all deposits to the extent not covered by the deposit protection schemes in Ireland or in any other jurisdiction;
- senior unsecured certificates of deposit;
- senior unsecured commercial paper ;
- other senior unsecured bonds and notes; and
- other forms of senior unsecured debt which may be specified by the Minister consistent with European Union State aid rules and the European Commission's Banking Communication (2008/C 270/02) and subject to prior consultation with the European Commission.

Dated subordinated debt and asset-covered securities issued after a covered institution joined the ELG Scheme are not guaranteed under the ELG Scheme. The total liabilities guaranteed under the ELG Scheme at 31 December 2012 amounted to €34 billion (€ 40 billion at 31 December 2011).

(b) Credit Institutions (Stabilisation) Act 2010
The Credit Institutions (Stabilisation) Act 2010 was passed into Irish law on 21 December 2010. The Act provides the legislative basis for the reorganisation and restructuring of the Irish banking system agreed in the joint EU/IMF Programme for Ireland ('the Programme'). This will allow the Minister to take the actions required to bring about a domestic retail banking system that is proportionate to and focused on the Irish economy. The Act provides broad powers to the Minister (in consultation with the Governor of the Central Bank of Ireland) to act on financial stability grounds to effect the restructuring actions and recapitalisation measures envisaged in the Programme. The Act applies to banks which have received financial support from the State, building societies and credit unions. Given the exceptional nature of the powers contained in the Act, the powers are time-limited and were scheduled to expire on 31 December 2012. However, in January 2013, the Minister extended the period of effectiveness of the Act for a further two years to 31 December 2014. The powers provided in the Act allow the Minister to implement key aspects of the agreed Programme for bank restructuring and include the issue of direction orders, special management orders, subordinated liabilities orders and transfer of assets and liabilities orders. In addition, the Act gives the Minister broad powers in relation to directors and officers and their appointment/removal/duties. Various other terms are also imposed on relevant financial institutions as a condition for financial support. Since the enactment of this legislation, the Minister has invoked certain of his powers under the Act in relation to AIB as follows:

(i) Direction Order
On 23 December 2010, the High Court, on application from the Minister, directed AIB, inter alia, to increase its authorised share capital; to issue ordinary and CNV shares to the NPRFC; to cancel its listing on the Main Securities Market and to apply for listing on the Enterprise Securities Market ("ESM") of the Irish Stock Exchange; and to complete the sale of its Polish interests to Banco Santander. Arising from this order on 23 December 2010, AIB issued ordinary and CNV shares to the NPRFC for net proceeds of €3.7 billion.

Notes to the accounts

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

(ii) Transfer order

On 24 February 2011, following an application by the Minister, the High Court issued a transfer order for the immediate transfer of certain deposits and corresponding assets from Anglo Irish Bank Corporation to AIB.

(iii) Subordinated Liabilities Order

On 14 April 2011, following an application by the Minister under section 29 of the Credit Institutions (Stabilisation) Act 2010, the High Court issued a Subordinated Liabilities Order (the "SLO") in relation to all outstanding subordinated liabilities and other capital instruments (including certain tier 1 capital instruments), with the consent of AIB. The High Court declared the SLO effective as of 22 April 2011. The effect of the SLO was to amend the terms of certain subordinated liabilities and other capital instruments.

(c) Funding support

AIB received funding from the Central Bank throughout the year through the ECB Monetary Policy Operation Sale and Repurchase Agreements. The total funding amounted to €22.2 billion at 31 December 2012 (2011: €30.8 billion). These agreements were for maturities of between 7 days and 3 months apart from the €11.25 billion in the three year LTRO which will mature in January and February 2015. The interest rates on these facilities are set by the Central Bank and advised to AIB.

(d) PCAR/PLAR

On 31 March 2011, the Central Bank of Ireland published the 'Financial Measures Programme Report' which detailed the outcome of its review of the capital (PCAR) and funding requirements (PLAR) of the domestic Irish banks. The PCAR/PLAR assessments followed the announcement of the EU-IMF Programme for Ireland in November 2010, in which the provision of an overall amount of €85 billion in financial support for the sovereign was agreed in principle. Up to €35 billion of this support was earmarked for the banking system, €10 billion of which was for immediate recapitalisation of the banks with the remaining €25 billion to be provided on a contingency basis. Arising from the 2011 PCAR and PLAR assessments, AIB, including EBS, was required to raise €14.8 billion in total capital (including €1.6 billion in contingent capital), all of which was subsequently raised. In addition, the target loan to deposit ratio was set at 122.5% for all banks including AIB, by the end of 2013. There was no PCAR stress test carried out in 2012, however, it is expected that one will be carried out some time in 2013.

(e) Acquisition of EBS Limited ("EBS")

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

(f)Relationship framework

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

(g) Central Bank and Credit Institutions (Resolution) Act 2011

The Central Bank and Credit Institutions (Resolution) Act 2011 was signed into law on 20 October 2011 and became effective on 28 October 2011. This legislation provides the Central Bank with additional powers to achieve an effective and efficient resolution regime for credit institutions that are failing or likely to fail and that is effective in protecting the Exchequer and the stability of the financial system and the economy. The Act gives the Central Bank power to take control of banks, appoint managers to run them and remove directors, staff and consultants and to move their deposits and loans to other banks. It provides for the establishment of a Credit Institution Resolution Fund which would provide a source of funding for the resolution of financial instability or in the event of an

Notes to the accounts

25. Summary of the relationship of the AIB Group with the Irish Government *(continued)*
(g) Central Bank and Credit Institutions (Resolution) Act 2011 (continued)
imminent serious threat to the financial stability of an authorised credit institution. Authorised credit institutions will be obliged to contribute to the resolution fund. The Act provides for the establishment of “Bridge-Banks” for the purpose of holding assets or liabilities which have been transferred under a transfer order. Bridge-Banks are only intended to hold such assets or liabilities on a temporary basis pending onward transfer as soon as possible. The Central Bank is empowered to make special management orders in relation to an authorised credit institution, or in relation to a subsidiary or holding company of the authorised credit institution in certain circumstances. The Act also provides powers to the Central Bank regarding the liquidation of authorised credit institutions. Authorised credit institutions may also be directed to prepare a recovery plan setting out actions that could be taken to facilitate the continuation or secure the business or part of the business of that institution.

The legislation which provides for a permanent statutory regime under which the Central Bank may exercise intervention powers when a relevant credit institution is in difficulty is expected, in due course, to replace the temporary emergency provisions of the Credit Institutions (Stabilisation) Act 2010 outlined above.

26. Related party transactions
(a) Transactions with Allied Irish Banks, p.l.c.
AIB Mortgage Bank is a subsidiary of Allied Irish Banks, p.l.c. (“AIB”). Banking transactions are entered into between AIB Mortgage Bank and AIB in the normal course of business. These include loans and deposits on an arms length basis. Interest paid to AIB and interest received from AIB is disclosed in Note 1 and Note 2 to the accounts. As at 31 December 2012, the total amounts of principal outstanding in respect of mortgage covered securities issued to Allied Irish Banks, p.l.c. was €1bn

Most of the Bank’s activities are outsourced to AIB under an Outsourcing and Agency Agreement. AIB as Service Agent for the Bank, originates residential mortgage loans through its retail branch network and intermediary channels in the Republic of Ireland, services the mortgage loans and provides treasury services in connection with financing as well as a range of support services.

The Bank’s activities are financed through the issuance of mortgage covered securities and a mortgage backed promissory note facility with the Central Bank, with the balance of funding being provided by AIB.

(b) Transactions with key management personnel
Loans to the Key Management Personnel, including executive and non-executive directors and senior executive officers, are made in the ordinary course of business on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons of similar standing not connected with AIB Mortgage 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 also made in the ordinary course of business, on terms available to other employees in the Bank generally, in accordance with established policy, within limits set on a case by case basis.

Loans to the Key Management Personnel, including executive and non-executive directors and senor executive officers, are made in the ordinary course of business on substantially the same terms, including interest rate and collateral, as those prevailing at the time for comparable transactions with other persons of similar standing not connected with AIB Mortgage 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 also made in the ordinary course of business, on terms available to other employees in the Bank generally, in accordance with established policy, within limits set on a case by case basis.

Notes to the Accounts

26. Related party transactions *(continued)*
Details of loan facility transactions with key management personnel and connected parties, as appropriate, with AIB Mortgage Bank are as follows:

	Balance at 31 December 2011 €'000	Amounts advanced during 2012 €'000	Amounts repaid during 2012 €'000	Balance at 31 December 2012 €'000
Michael Keegan				
Loans	389	–	**9**	**380**
Interest charged during 2012				**8**
Maximum debit balance during 2012				**389**
Catherine Woods				
Loans	106	–	**9**	**97**
Interest charged during 2012				**2**
Maximum debit balance during 2012				**106**

No other current or former Directors, in office during 2012, had loans facilities with AIB Mortgage Bank during the year ended 31 December 2012.

Aggregate loan amounts outstanding at year end	2012 €'000	2011 €'000
Directors	**477**	1,569

(c) Connected Persons
There were no loans to connected persons of Directors in office as at 31 December 2012, as defined in section 26 of the companies act 1990

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

(d) Funding Support
At 31 December 2012, the mortgage covered securities issued to AIB Mortgage Bank of €6.0bn were repoed for value €5.0bn with Allied Irish Banks, p.l.c. and then were subject to a sale and repurchase agreement with the ECB, providing liquidity for AIB Group of €5.1bn.

The AIB Mortgage Bank Mortgage-Backed Promissory Note facility with the Central Bank, for normal ECB open market operations, is unavailable since December 2010 due to ratings downgrade by Moody's of Allied Irish Banks, p.l.c. The AIB Mortgage Bank Mortgage-Backed Promissory Note Framework has been used as a source of liquidity with the Central Bank of Ireland outside of normal ECB open market operations during first four months of 2011.

(e) Interest rate risk hedging
The Bank manages the interest rate risk through two different types of interest rate swaps with Allied Irish Banks p.l.c. The first type is used to hedge interest rate risk on mortgage loan accounts both within the Cover Assets Pool and outside the Cover Assets Pool, effectively converting interest receivable from a fixed rate basis to a floating rate basis. The notional amount of the swaps used to hedge the interest rate risk on mortgage loan accounts at 31 December 2012 was €23.9bn.

Notes to the Accounts

26. Related party transactions *(continued)*
The second type of interest rate swaps are vanilla interest rate swaps used to hedge the mortgage covered securities, converting interest payable from a fixed rate basis to a floating rate basis. The notional amount of the swaps used to hedge the interest rate risk on mortgage covered securities at 31 December 2012 was €3.27bn.

27. Business Combination
On 25 February 2011, AIB Mortgage Bank acquired an intermediary mortgage business from Allied Irish Banks, p.l.c.. As the acquisition was deemed to be the acquisition of a business and the transaction was between entities under common control, it was accounted for under the carrying value basis in line with both the AIB Group and Bank's accounting policy.

The net carrying value of this business was €4.2bn which was comprised of loans and receivables, related loan loss provisions and accrued interest. Consideration paid was €4.2bn.

From the date of acquisition this business contributed €94.5m in interest income. Management estimate that revenues would have been €113.4m had the business been acquired effective 1 January 2011.

At the date of acquisition the loan loss provision was €107m. The loan loss specific provision 2011 charge for these loans was €64m.

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

29. Approval of financial statements
The financial statements were approved by the Directors on 22 March 2013.