

AIB Mortgage Bank

Directors' Report & Financial Statements

Year ended 31 December 2006

AIB Mortgage Bank

Directors' report and financial statements

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AIB Mortgage Bank

Directors' and other information

Directors

John O'Donnell (Chairman)
Maeliosa Ó hOgartaigh (Deputy Chairman)
David Kelly* (Managing Director)
Seymour Cresswell*
Kieran Crowley
David Griffin*
Michael Keegan*
Gerry O'Connor*
Jennifer Winter

* Executive Director

Registered office

Bankcentre
Ballsbridge
Dublin 4
Ireland

Secretary

John Burns

Auditor

KPMG
Chartered Accountants
1 Harbourmaster Place
International Financial Services Centre
Dublin 1
Ireland

Solicitor

Office of the Law Agent
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

AIB Mortgage Bank

Directors' Report

The Directors present their report and financial statements for the year ended 31 December 2006, the first report since AIB Mortgage Bank commenced operations on 13 February 2006. A statement of Directors' Responsibilities in relation to the financial statements appears on page 7.

Principal activities

AIB Mortgage Bank ('the Bank') was incorporated on 11 July 2005 in Ireland under the Companies Acts, 1963 to 2005 as a public limited company under the name AIB Mortgage Bank p.l.c. It was subsequently re-registered as a public unlimited company under the name AIB Mortgage Bank. It 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. AIB Mortgage Bank, which is a wholly owned subsidiary of Allied Irish Banks, p.l.c., ('AIB') is regulated by the Central Bank and Financial Services Regulatory Authority of Ireland ('CBFSAI'). 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 Act, 2001. Such loans may be made directly by the Bank or may be purchased from Allied Irish Banks, p.l.c. and other subsidiary undertakings of AIB Group or third parties.

The Bank did not trade in the period from its incorporation up to 13 February 2006. On 13 February 2006, Allied Irish Banks, p.l.c. transferred its Irish branch originated residential mortgage business to AIB Mortgage Bank, amounting to €13.6 bn in mortgage loans; certain other categories of Allied Irish Banks, p.l.c. residential mortgage loans were not included in this transfer. On 24 February 2006, a mortgage backed promissory note facility between AIB Mortgage Bank and the Central Bank and Financial Services Regulatory Authority of Ireland was put in place.

In March 2006 the Bank launched a €15 bn Mortgage Covered Securities Programme.

Business review, future developments, risks and uncertainties

Organisation and Governance

AIB Mortgage Bank is a 100% owned subsidiary and as such is under the control of AIB. As a designated mortgage credit institution under the Asset Covered Securities Act, 2001, its business activities are restricted 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.

Most of the Bank's activities are outsourced to Allied Irish Banks, p.l.c. under an Outsourcing and Agency Agreement. Allied Irish Banks, p.l.c., as Service Agent for the Bank, originates residential mortgage loans through its retail branch network 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.

The Bank's activities are financed through the issuance of mortgage covered securities and a mortgage backed promissory note facility with the Central Bank and Financial Services Regulatory Authority of Ireland, with the balance of funding being provided by Allied Irish Banks, p.l.c.

Governance is exercised through a Board of Directors, chaired by the Group Finance Director of AIB, with three non executive Directors (two of whom are independent non executive Directors of Allied Irish Banks, p.l.c.) and five Executive Directors drawn from the AIB Bank Republic of Ireland Division and AIB Capital Markets Division.

Strategy

The residential mortgage market is a key component of AIB's overall approach to the personal banking market. AIB's strategy for the residential mortgage business is to achieve profitable growth in market share while preserving credit quality.

AIB Mortgage Bank

Directors' Report

Developments

As reported above, the Bank commenced mortgage business operations and related financing activities during the year.

Outlook

The Board considers that the outlook for the Irish economy and employment continues to be favourable and that these factors will support good levels of activity in the residential housing market. In 2007, we may see some moderation in growth in the residential mortgage loan business. Further issuance of mortgage covered securities is planned.

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 Note 7 of the Financial Statements.

Results for the year

The results for the year ended 31 December 2006 are wholly in respect of activity since the Bank commenced operations on 13 February 2006. Profit before taxation was €9.7m.

The residential mortgage loan business has performed strongly. The mortgage loan book increased from €3.6 bn at 13 February to €6.3 bn at 31 December 2006. Asset quality has remained strong.

Net interest income was €26.5m. Interest income on mortgage loans was €17.5m and on deposits and interest rate swaps with Allied Irish Banks, p.l.c. was €13.2m. Interest payable to the Central Bank and Financial Services Regulatory Authority of Ireland in respect of the mortgage backed promissory note facility was €5.8m, to holders of mortgage covered securities was €6.6m and to Allied Irish Banks, p.l.c. on funding and on interest rate swaps was €401.8m.

Changes in fair value of interest rate swaps and certain related account items being hedged resulted in a reported trading loss of €15.1m. Interest rate swaps are used solely to minimise interest rate risk, which the Directors consider is achieved from an economic standpoint and that interest rate risk management complies with the requirements of the Asset Covered Securities Act, 2001.

Administrative expenses amounted to €39.2m, and included €38.1m for services provided by Allied Irish Banks, p.l.c. under the Outsourcing and Agency Agreement.

Profit after taxation amounted to €1.0m. The Board is not recommending the payment of a dividend in respect of the year ended 31 December 2006.

Financing

During the year, the Bank undertook public issues of mortgage covered securities (or covered bonds) under its €15 bn Mortgage Covered Securities Programme as follows:

- On 5 April, €2.5 bn 3 year mortgage covered securities due 30 April 2009 were issued.
- On 6 April, €1.0 bn 7 year mortgage covered securities due 30 April 2013 were issued.
- On 13 December, €2.0 bn 3 year mortgage covered securities due 29 January 2010 were issued.

The total amounts of principal outstanding in respect of mortgage covered securities issued was €5.5 bn as at 31 December 2006.

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Directors' Report

Share capital and subordinated liabilities

The share capital of the Bank was increased from €40,000 at 31 December 2005 to €405,000,000 (ordinary shares of €1 each) at 31 December 2006 by the issue of shares for cash to Allied Irish Banks, p.l.c. as follows:

- On 20 January by the issue of 6,350,000 shares
- On 13 February by the issue of 350,000,000 shares
- On 29 September by the issue of 43,610,000 shares
- On 20 December by the issue of 5,000,000 shares

On 13 February 2006, the Bank issued to Allied Irish Banks, p.l.c., for cash at par, a €100m subordinated capital note due 2031 and a €200m subordinated perpetual loan capital note.

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 company's registered office.

Directors

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

Mr. Aidan Clarke resigned as a Director on 20 January 2006. The following Directors were appointed to the Board on 20 January 2006: Mr. Seymour Cresswell, Mr. Kieran Crowley, Mr. Michael Keegan, Mr. David Kelly, Mr. Declan McSweeney, Mr. Gerry O'Connor, Mr. John O'Donnell and Ms. Jennifer Winter.

Mr. Declan McSweeney resigned from the Board on 30 November 2006. Mr. Maeliosa O'hOgartaigh was appointed as a Director on 31 January 2007.

Directors' and Secretary's interests in shares

The beneficial interests of the Directors and the Secretary in office at 31 December 2006 and of their spouses and minor children in the shares of group companies are set out below. The shares referred to are €0.32 ordinary shares in Allied Irish Banks, p.l.c., the holding company.

	31 December 2006	1 January 2006*
Ordinary shares		
Directors:		
Seymour Cresswell	1,970	2,032
Kieran Crowley	12,520	7,520
David Griffin	6,107	5,460
Michael Keegan	3,146	2,499
David Kelly	64,824	60,489
Gerry O'Connor	27,224	26,841
John O'Donnell	9,491	8,844
Jennifer Winter	480	280
Secretary:		
John Burns	3,336	1,404

* or later date of appointment

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Directors' Report

Share options

Details of the Executive Directors' and the Secretary's share options are given below. The options outstanding at 31 December 2006 are exercisable at various dates between 2007 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 2006	1 January 2006*	Since 1 January, 2006*		Price of options exercised	Market price at date of Exercise	Weighted average subscription price of options outstanding at 31 December, 2006
			Granted	Exercised	€	€	€
Directors:							
Seymour Cresswell	Nil	Nil	-	-	-	-	-
David Griffin	22,500	22,500	-	-	-	-	€13.75
Michael Keegan	22,500	32,500	-	10,000	€1.98	€9.81	€3.24
David Kelly	35,000	48,000	-	13,000	€0.02	€9.24	€3.48
Gerry O'Connor	10,500	10,500	-	-	-	-	€3.10
John O'Donnell	96,000	96,000	-	-	-	-	€3.23
Secretary:							
John Burns	4,000	5,500	-	1,500	€1.98	€8.30	€4.40

* or later date of appointment

Mr. O'Connor also has options to purchase 1,383 AIB shares under the AIB Group UK plc Sharesave Scheme.

Long term incentive plans

Under the terms of the Allied Irish Banks, p.l.c. Long Term Incentive Plans, approved by shareholders of Allied Irish Banks, p.l.c., conditional awards of shares may be granted to key executives and other employees. Details of the executive Directors' and Secretary's conditional grants of awards of shares are given below:

	Total as at 31 December 2006	Lapsed during 2006	Granted during 2006	Total as at 1 January 2006*
Directors:				
Seymour Cresswell	Nil	Nil	Nil	Nil
David Griffin	9,157	5,000	9,157	5,000
Michael Keegan	12,616	4,100	8,116	8,600
David Kelly	15,489	4,800	10,989	9,300
Gerry O'Connor	5,452	4,000	5,452	4,000
John O'Donnell	67,737	6,000	31,397	42,340
Secretary:				
John Burns	Nil	Nil	Nil	Nil

* or later date of appointment

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. Mr. Maeliosa Ó hOgartaigh, who was appointed to the Board on 31 January 2007, has interests (inclusive of the interests of his wife and minor children) in 8,833 shares of Allied Irish Banks, p.l.c.; he has options over 43,000 shares, and conditional grants of awards of 12,035 shares under the Long Term Incentive Plans.

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Directors' Report

Other than Mr. Ó hOgartaigh's appointment to the Board, there were no changes in the above interests between 31 December 2006 and 30 March 2007 save for the receipt by Mr. O'Connor of 24 shares under the Allied Irish Banks, p.l.c. UK Share Ownership Plan.

Post balance sheet events

No significant events have occurred in the period subsequent to the year end date and the date of approving the financial statements.

Independent auditor

The auditors, KPMG, Chartered Accountants, have signified willingness to continue in office under Section 160 (2) of the Companies Act, 1963.

On behalf of the Board

Chairman John O'Donnell

Managing Director David J. Kelly

30 March 2007

AIB Mortgage Bank

Statement of Directors' responsibilities in relation to the Financial Statements

The Directors are responsible for preparing the Annual Report in accordance with applicable laws and regulations.

The Companies Acts require the Directors to prepare company financial statements for each financial year. Under the Acts the Directors are required to prepare the Company's financial statements in accordance with International Financial Reporting Standards ('IFRS') as adopted by the EU and applicable law.

The financial statements are required by law and IFRS to present fairly the financial position and performance of the Bank; the Companies Acts provide in relation to such financial statements that references 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 judgments 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 2006. 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 also responsible for preparing a Directors' Report that complies with the requirement of the Companies Acts 1963 to 2006.

On behalf of the Board

Chairman John O'Donnell

Managing Director David J. Kelly

30 March 2007

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Independent auditor's report to the members of AIB Mortgage Bank

We have audited the financial statements of AIB Mortgage Bank for the year ended 31 December 2006 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Recognised Income and Expense and the related notes. These financial statements have been prepared under the accounting policies set out therein.

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 auditor

The Directors' responsibilities for preparing the Annual Report and the financial statements in accordance with applicable law and International Financial Reporting Standards (IFRS) as adopted by the EU are set out in the Statement of Directors' Responsibilities on page 7.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland).

We report to you our opinion as to whether the financial statements give a true and fair view in accordance with IFRS as adopted by the EU and have been properly prepared in accordance with the Companies Acts 1963 to 2006, and Article 4 of the IAS regulation.

We also report to you whether, in our opinion:

- proper books of account have been kept by the Company;
- whether at the balance sheet date, there exists a financial situation requiring the convening of an extraordinary general meeting of the Company; and
- whether the information given in the Directors' Report is consistent with the financial statements.

In addition, we state whether we have obtained all the information and explanations necessary for the purposes of our audit, and whether the Company's balance sheet is in agreement with the books of account. We also report to you if, in our opinion, any information specified by law regarding Directors' remuneration and Directors' transactions is not disclosed and, where practicable, include such information in our report.

We read the other information contained in the Annual Report and consider whether it is consistent with the audited financial statements. The other information comprises only the Directors' Report. We consider the implications for our report if we become aware of any apparent mis-statements or material inconsistencies with the financial statements. Our responsibilities do not extend to any other information.

Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements.

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Basis of audit opinion *(continued)*

It also includes an assessment of the significant estimates and judgments made by the Directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the Company's circumstances, consistently applied and adequately disclosed.

We planned and performed our audit so as to obtain all the information and explanations which we considered necessary in order to provide us with sufficient evidence to give reasonable assurance that the financial statements are free of material misstatement, whether caused by fraud or other irregularity or error. In forming our opinion we also evaluated the overall adequacy of the presentation of information in the financial statements.

Opinion

In our opinion:

- the financial statements give a true and fair view, in accordance with IFRSs as adopted by the EU, of the state of the Company's affairs as at 31 December 2006 and of its profit for the year then ended;
- the financial statements have been properly prepared in accordance with the Companies Acts 1963 to 2006, and Article 4 of the IAS regulation.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the Company. The Company's balance sheet is in agreement with the books of account.

In our opinion the information given in the Directors' Report is consistent with the financial statements.

The net assets of the Company, as stated in the balance sheet 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 2006 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.

KPMG
Registered Auditors
Chartered Accountants
1 Harbourmaster Place
International Financial Services Centre
Dublin 1

30 March 2007

AIB Mortgage Bank

Accounting policies

The accounting policies applied in the preparation of the financial statements for the year ended 31 December 2006 are set out below.

Status of AIB Mortgage Bank

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 Act, 2001. It is a wholly owned subsidiary of Allied Irish Banks, p.l.c. and is regulated by the Central Bank and Financial Services Regulatory Authority 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 Act, 2001. Such loans may be made directly by the Bank to customers through the AIB branch network in the Republic of Ireland or may be purchased from Allied Irish Banks, p.l.c. and other members of the group or third parties.

On 13 February 2006, Allied Irish Banks, p.l.c. transferred its Irish branch originated residential mortgage business to AIB Mortgage Bank, amounting to €13.6 bn in mortgage loans and the Bank commenced operations. The results for the year ended 31 December 2006 are wholly in respect of activity since the Bank commenced operations on 13 February 2006 as the Bank did not trade prior to this date.

1. Statement of compliance

The financial statements have been presented in accordance with International Accounting Standards and International Financial Reporting Standards (collectively 'IFRS') as adopted by the European Union ("EU") and applicable at 31 December 2006. The financial statements also comply with the requirements of Irish Statute comprising the Companies Acts 1963 to 2006, the Asset Covered Securities Act, 2001 and the European Communities (Credit Institutions Accounts) Regulations, 1992 as amended by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005.

2. Basis of preparation

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

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

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of accounting 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 these circumstances. Since management's 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 period affected. The estimates that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of impairment of financial assets and fair value of certain financial assets and liabilities. A description of these estimates and judgements is set out within item 14 of this section.

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Accounting policies

3. 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 expected future cash payments or receipts through the expected life of the financial instrument, 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 early redemption, between parties to the contract that are an integral part of the effective interest rate 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.

4. Fee and commission income

Fees and commissions are generally recognised on an accruals basis when the service has been provided.

5. Net trading income

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

6. Financial assets

Loans and advances

Loans and advances are non-derivative financial assets with fixed or determinable payments that are not quoted on 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 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 company has transferred substantially all the risks and rewards of ownership.

7. Financial liabilities

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

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Accounting policies

7. Financial liabilities (*continued*)

Financial liabilities are initially recognised at fair value, being the issue proceeds (fair value of consideration received) net of transaction costs incurred. Financial liabilities are subsequently measured at amortised cost, 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.

Refer to derivatives and hedge accounting, set out within item 8 of this section, for the accounting policy for financial liabilities in a hedge accounting relationship.

8. Derivatives and hedge accounting

Derivatives, such as interest rate swaps, are used only for hedging purposes.

Derivatives

Derivatives are measured initially at fair value on the date on which the derivative contract is entered into and subsequently remeasured at fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and 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 liabilities when their fair value is negative, unless there is the legal ability and intention to settle net. 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.

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.

Hedging

All derivatives are carried at fair value in the balance sheet 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, the Bank designates certain derivatives as hedges of the fair value of recognised assets or liabilities of 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:

- (a) it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;
- (b) the derivative expires, or is sold, terminated, or exercised;
- (c) the 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.

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Accounting policies

8. Derivatives and hedge accounting *(continued)*

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

Fair value hedge accounting

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

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

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.

9. Impairment of financial assets

It is company policy to make provisions for impairment of financial assets to reflect the losses inherent in those assets at the balance sheet date.

The Bank assesses whether there is objective evidence that a financial asset or a portfolio of financial assets is impaired at each balance sheet 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 and on or before the balance sheet 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;
- (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;
 - (ii) national or local economic conditions that correlate with defaults on the assets in the portfolio.

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Accounting policies

9. Impairment of financial assets *(continued)*

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.

For loans and advances, 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 the amount of the loss is charged to the income statement.

When a loan has been subject to a specific provision and there is no more than a remote likelihood of recovery of such amount, the amount 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.

10. Employee benefits

Retirement benefit obligations

The Bank provides employees with post retirement benefits mainly in the form of pensions. It is the company's policy to provide for pension and other post-retirement benefits at rates recommended by independent actuaries. Staff members of the company are members of 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. The standard contribution rate in Ireland is 8%.

11. 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.

12. Income tax

Income tax comprising current 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 balance sheet date and any adjustment to tax payable in respect of previous years. Income tax payable on profits based on the applicable tax law is recognised as an expense in the period in which the profits arise.

13. Cash and cash equivalents

For the purposes of the cash flow statement, 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.

AIB Mortgage Bank

Accounting policies

14. 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*

The estimation of potential loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local and international economic climates and other external factors such as legal and regulatory requirements. For example, should the expectation of loss within a portfolio increase, then this may result in an increase to the required incurred but not reported ('IBNR') loan loss provision level.

A specific provision 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 account. The amount of the specific provision made in the Bank's financial statements 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. 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 management on a regular basis. A system for grading advances according to agreed credit criteria exists with an important objective being the timely identification of vulnerable loans so that remedial action can be taken at the earliest opportunity. Credit rating is fundamental to the determination of provisioning in the Bank; it triggers the process which results in the creation of a specific provision on individual loans where there is doubt on recoverability.

IBNR provisions are also maintained to cover loans, which are impaired at balance sheet 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 and current estimates of expected loss in the portfolio.

Estimates of expected loss are driven by the following key factors;

- (a) Probability of default i.e. the likelihood of a customer defaulting on its obligations over the next 12 months,
- (b) Loss given default i.e. the fraction of the exposure amount that will be lost in the event of default, and
- (c) Exposure at default i.e. exposure is calculated by adding the expected drawn balance plus a percentage of the unused limits.

AIB's rating systems have been internally developed and are continually being enhanced, e.g. externally benchmarked, to help underpin the aforementioned factors which determine the estimates of expected loss. Estimated expected loss is only one element in assessing the adequacy of the Bank's allowances.

Provisions and provision adequacy are approved on a quarterly basis. These provisions are in turn reviewed and approved by the AIB Republic of Ireland Division on a quarterly basis with ultimate levels being approved by the AIB Mortgage Bank Audit Committee and the AIB Mortgage Bank Board of Directors.

AIB Mortgage Bank

Accounting policies

14. Accounting estimates and judgements

(b) Fair value of financial instruments

Some of the Bank's financial instruments are carried at fair value, including all derivatives. Financial instruments are either priced with reference to a quoted market price for that instrument or by using a valuation model. Where the fair value is calculated using financial-markets pricing models, the methodology is to calculate the expected cash flows under the terms of each specific contract and then discount these values back to a present value. These models use as their basis independently sourced market parameters including, for example, interest rate yield curves. The valuation model used for a particular instrument, the quality and liquidity of market data used for pricing, other fair value adjustments not specifically captured by the model and market data are all subject to internal review and approval procedures and consistent application between accounting periods.

15. 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.

16. 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 a 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.

17. Prospective accounting changes

The following standards/amendments to standards have been approved by the International Accounting Standards Board (IASB) and were adopted by the EU in January 2006 but not early adopted by the Bank. These will be adopted in 2007 and thereafter.

Amendment to IAS 1- Capital disclosures (effective 1 January 2007). This amendment requires disclosure both quantitative and qualitative of an entity's objectives, policies and processes for managing capital.

IFRS 7 Financial instrument disclosures (effective 1 January 2007) has not been adopted in the accounts as it is not required by law for the year ended 31 December 2006. This accounting standard will supersede IAS 30 Disclosures in the Financial Statements of Banks and Similar Financial Institutions and the disclosure requirements of IAS 32 Financial Instruments, both of which have been adopted in preparing the accounts for the year ended 31 December 2006.

The EU Transparency Directive is due for transposition into Irish Law in 2007. Accordingly it will impact company reporting from 1 January 2008. The directive seeks to enhance transparency in EU capital markets in order to improve investor protection and market efficiency. The directive sets out publication deadlines and content requirements in relation to annual financial reports and half yearly financial reports.

AIB Mortgage Bank

Income Statement

for the year ended 31 December 2006

		31 Dec 2006 €000	Period ended 31 Dec 2005 €000
	Notes		
Interest and similar income	1	630,665	-
Interest expense and similar charges	2	(504,205)	-
Net interest income		126,460	-
Trading loss	3	(15,088)	-
Other operating income		4	-
Total operating income		111,376	-
Administrative expenses	4	(39,169)	-
Operating Profit before provisions		72,207	-
Provisions for impairment of loans and advances	5	(2,469)	-
Operating Profit before taxation		69,738	-
Taxation on ordinary activities	6	(8,717)	-
Profit for the financial year		61,021	-

The notes on pages 22 to 38 are an integral part of these financial statements.

Chairman John O'Donnell

Managing Director David J Kelly

Finance Director Michael L Keegan

Secretary John Burns

30 March 2007

AIB Mortgage Bank

Balance sheet

as at 31 December 2006

	Notes	31 Dec 2006 €000	31 Dec 2005 €000
Assets			
Cash and balances at central bank		25	-
Loans and receivables to banks	9	6,999,839	40
Loans and receivables to customers	10	16,312,425	-
Other assets	11	33,553	-
Total assets		23,345,842	40
Liabilities			
Deposits by banks	12	16,965,052	-
Customer accounts		1,047	-
Derivative financial instruments	8	91,388	-
Debt securities in issue	13	5,423,700	-
Current taxation	6	717	-
Other liabilities		760	-
Accruals and deferred income	14	97,157	-
Subordinated liabilities	15	300,000	-
Total liabilities		22,879,821	-
Shareholders' equity			
Share capital	16	405,000	40
Profit and loss account		61,021	-
Total shareholders' equity		466,021	40
Total liabilities and shareholders' equity		23,345,842	40

Chairman John O'Donnell

Managing Director David J. Kelly

Finance Director Michael L. Keegan

Secretary John Burns

30 March 2007

AIB Mortgage Bank

Statement of cash flows

for the year ended 31 December 2006

	31 Dec 2006 €000	Period ended 31 Dec 2005 €000
Reconciliation of profit before taxation to net cash inflow from operating activities		
	Notes	
Profit before taxation	69,738	-
Increase in prepayments and accrued income	(33,398)	-
Increase in accruals and deferred income	97,157	-
Increase in customer accounts	1,047	-
Increase in cash and balances at central bank	(25)	-
Increase in loans and receivables to customers	(16,312,425)	-
Increase in debt securities in issue	5,423,700	-
Increase in derivative financial instruments	91,388	-
Increase in loans and receivables to Allied Irish Banks, p.l.c.	(6,942,982)	-
Increase in loans and receivables from Allied Irish Banks, p.l.c.	16,965,092	-
Increase in other assets	(155)	-
Increase in other liabilities	760	-
Net cash flow from operating assets and liabilities	(640,103)	-
Net cash inflow from operating activities before taxation		
Taxation paid	(8,000)	-
Net cash flow from operating activities	(648,103)	-
Financing activities		
Issue of Subordinated Liabilities	300,000	-
Issue of Ordinary Shares	404,960	40
Increase/(decrease) in cash and cash equivalents	56,857	40
Opening cash and cash equivalents	40	-
Closing cash and cash equivalents	56,897	40

AIB Mortgage Bank

Statement of recognised income and expense

for the year ended 31 December 2006

	Notes	31 Dec 2006 €000	Period ended 31 Dec 2005 €000
<hr/> Income and expense recognised directly in equity <hr/>			
Profit for the year		61,021	-
<hr/>			
Total recognised income and expense for the year		61,021	-
<hr/>			

AIB Mortgage Bank

Reconciliation of movements in shareholders' equity

for the year ended 31 December 2006

	Share capital €000	Profit and loss account €000	Total €000
<hr/>			
Balance at 1 January 2005			
Ordinary shares issued	40	-	40
<hr/>			
Balance at 31 December 2005	40	-	40
<hr/>			
Balance at 1 January 2006	40	-	40
Profit attributable to equity holders	-	61,021	61,021
Ordinary shares issued	404,960	-	404,960
<hr/>			
Balance at 31 December 2006	405,000	61,021	466,021
<hr/>			

AIB Mortgage Bank

Notes to the accounts

	2006 €000	2005 €000
1. Interest and similar income		
Interest on loans and receivables to customers	517,466	-
Interest receivable from Allied Irish Banks, p.l.c.	113,199	-
	630,665	-

All income earned derives from activities carried out in the Republic of Ireland.

	2006 €000	2005 €000
2. Interest expense and similar charges		
Interest payable to Allied Irish Banks, p.l.c.	401,765	-
Interest on debt securities in issue	96,610	-
Interest on amounts due to the Central Bank and Financial Services Authority of Ireland	5,830	-
	504,205	-

3. Trading loss

Changes in fair value of interest rate swaps, and certain related account items being hedged, resulted in a trading loss of €15.1m. A loss of €12.9m arose as a result of changes in fair value of swaps used to hedge the interest rate risk in the mortgage loan portfolio. While these swaps are highly effective in managing interest rate risk from an economic standpoint, it is not possible to establish accounting fair value hedging relationships between the swaps and the mortgage loan portfolio. As a result the mortgage loan portfolio is not reported at fair value but is reported on an amortised cost basis. This treatment may give rise to volatility in reported income. The balance of the trading loss, €2.2 m, is in respect of the ineffectiveness of the hedge for mortgage covered securities and represents the difference in the changes to fair value of interest rate swaps and of the related mortgage covered securities being hedged.

AIB Mortgage Bank

Notes to the accounts

	2006	2005
	€000	€000
4. Administrative expenses		
<hr/>		
Staff costs		
Wages and salaries	305	-
Social security costs	32	-
Pension costs	17	-
Other staff costs	3	-
	357	
Other administrative expenses	670	-
Amounts payable to Allied Irish Banks, p.l.c. under the Outsourcing and Agency Agreement	38,142	-
	39,169	-
<hr/>		

5. Provisions for impairment of loans and advances

	2006			2005		
	Specific	IBNR	Total	Specific	IBNR	Total
	€000	€000	€000	€000	€000	€000
Transfer from Allied Irish Banks, p.l.c. on 13 th February 2006.	5,553	4,060	9,613	-	-	-
Charge against income statement	535	1,934	2,469	-	-	-
At end of year	6,088	5,994	12,082	-	-	-

AIB Mortgage Bank

Notes to the accounts

	2006 €000	2005 €000
<hr/>		
6. Taxation		
Current Tax		
Profit before tax €69.7m @ 12.5%	8,717	-
<hr/>		
Total income tax expense	8,717	-
<hr/>		

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

7. Risk management

Set out below are details on the risk management framework and interest rate sensitivities for AIB Mortgage Bank.

Risk management

Taking and managing risk for an appropriate return is central to creating shareholder value. Day-to-day risk management in the Bank centres on four major risks – credit, operational, interest rate and liquidity risks. The Board of Directors of AIB Mortgage Bank approves policies in respect to each of the four risks.

The Bank's risk management policies and practices are fully in line with those of its parent, Allied Irish Banks, p.l.c. Details of AIB Group's risk management policies are set out in the Annual Report of Allied Irish Banks, p.l.c.

Risk management in the Bank is supported by an Outsourcing and Agency Agreement with its parent, Allied Irish Banks, p.l.c.

Credit risk

Credit risk is the exposure to loss due to counterparty default on credit obligations. It arises in the Bank's residential mortgage loan portfolio.

Day-to-day credit risk management for the Bank is performed by its parent, Allied Irish Banks, p.l.c. Accordingly, credit risk is managed and controlled on the basis of established credit processes within a framework of credit policy and delegated authorities based on skill and experience. Credit grading and monitoring systems accommodate the early identification and management of deterioration in loan quality. In addition, the process is underpinned by an independent system of credit review.

The residential lending policies are reviewed and updated on a regular basis. The AIB Group Credit Committee approves key credit policies and influences strategic portfolio management. It also reviews trends in credit quality and determines overall provision adequacy. There is an independent credit risk management unit which has functional responsibility for credit risk across Allied Irish Banks, p.l.c.

AIB Mortgage Bank

Notes to the accounts

7. Risk management *(continued)*

Credit risk *(continued)*

AIB invests significantly in developing the professional skills of its lenders and in the continuous improvement of the credit assessment, control and monitoring processes. High priority is given to having a credit culture that is resilient through business cycles.

Credit risk also arises in derivative contracts which are entered into to hedge the interest rate exposure of AIB Mortgage Bank. Such derivative contracts are only entered into with the parent company, Allied Irish Banks, p.l.c.

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 money laundering prevention, compliance, 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.

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. Interest rate swaps are used to modify the repricing characteristics of assets and liabilities in order to minimise the exposure to interest rate risks. All interest rate swaps are contracted with the parent company, Allied Irish Banks, p.l.c. Interest rate swaps are used to hedge the mortgage covered securities in issue and the Bank's mortgage loan portfolio. Interest rate swaps are used solely for hedging and not trading purposes.

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

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 is managed as part of the overall AIB Group liquidity management. In addition, the Bank has fulfilled its regulatory requirement to hold on a continuous basis liquid assets equal to at least 25% of total borrowings.

Interest rate sensitivity

The net interest rate sensitivity of AIB Mortgage Bank at 31 December 2006 is illustrated in the following table. This information is presented for eight different time periods reflecting the balances of assets and liabilities with rates that are subject to change within each period, data regarding balances which are not sensitive to interest rate movements and any rate sensitive off-balance sheet contracts. The table shows the sensitivity of the balance sheet at one point in time and is not necessarily indicative of positions at other dates. In developing the classifications used in the table it has been necessary to make certain assumptions and approximations in assigning assets and liabilities to different repricing categories.

AIB Mortgage Bank

Interest rate sensitivity

7. Risk management (continued)

Interest rate sensitivity analysis for the Bank at 31 December 2006 is as follows:

	0<1mths €000	1<3mths €000	3<12mths €000	1<2yrs €000	2<3yrs €000	3<4yrs €000	4<5yrs €000	5+yrs €000	Rate Insensitive €000	Total €000
Assets										
Cash and balances at central bank	25									25
Loans and receivables to customers	14,130,739	110,324	779,910	387,589	526,741	107,751	194,426	74,945		16,312,425
Loans and receivables to banks	6,999,839									6,999,839
Other assets									33,553	33,553
Total Assets	21,130,603	110,324	779,910	387,589	526,741	107,751	194,426	74,945	33,553	23,345,842
Liabilities										
Customer accounts									1,047	1,047
Deposits by banks	16,965,052									16,965,052
Derivative financial instruments									91,388	91,388
Debt issued					2,500,000	2,000,000		1,000,000	(76,300)	5,423,700
Subordinated liabilities	300,000									300,000
Other liabilities									98,634	98,634
Shareholder's funds									466,021	466,021
Total Liabilities	17,265,052	-	-	-	2,500,000	2,000,000	-	1,000,000	580,790	23,345,842
Derivative Financial Instruments (interest rate swaps)										
Floating rate interest receivable	16,321,214									16,321,214
Floating rate interest payable	(14,139,528)	(110,324)	(779,910)	(387,589)	(526,741)	(107,751)	(194,426)	(74,945)		(16,321,214)
Floating rate interest payable	(5,500,000)									(5,500,000)
Fixed rate interest receivable					2,500,000	2,000,000		1,000,000		5,500,000
Total Derivatives	(3,318,314)	(110,324)	(779,910)	(387,589)	1,973,259	1,892,249	(194,426)	925,055	-	-
Interest Sensitivity Gap	547,237	-	-	-	-	-	-	-	(547,237)	-
Cumulative Interest Sensitivity Gap	547,237	547,237	547,237	547,237	547,237	547,237	547,237	547,237	-	-

AIB Mortgage Bank

Notes to the accounts

8. 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 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 its 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.

	31 Dec 2006 €000	31 Dec 2006 €000
	Contract/ Notional Amount	Fair Value Asset/ (Liability)
Derivatives classified as trading		
Hedging mortgage loan accounts – outside the Cover Assets Pool	8,538,235	(7,849)
Hedging mortgage loan accounts – within the Cover Assets Pool	<u>7,782,979</u>	<u>(5,050)</u>
Total Derivatives classified as trading	<u>16,321,214</u>	<u>(12,899)</u>
Derivatives classified as hedging (Debt Securities)		
Interest Rate Swaps	<u>5,500,000</u>	<u>(78,489)</u>
Total Derivatives classified as hedging (Debt Securities)	<u>5,500,000</u>	<u>(78,489)</u>
Total Derivatives	<u>21,821,214</u>	<u>(91,388)</u>

The following table represents the underlying principal and gross replacement costs of the Bank’s derivatives as at 31 December 2006.

31 December 2006	Within one year €000	Residual Maturity > one year < 5 Yrs €000	Total €000
Underlying principal amount			
Interest rate contracts	<u>16,321,214</u>	<u>5,500,000</u>	<u>21,821,214</u>
Gross replacement costs			
Interest rate contracts	-	<u>34,306</u>	<u>34,306</u>

AIB Mortgage Bank

Notes to the accounts

8. Derivatives and other financial instruments (continued)

These tables present the notional and fair value amounts, weighted average maturity and weighted average receive and pay rates for instruments held for risk management purposes entered into by the Bank in 2006.

	Notional principal amount €000	Weighted average maturity in years	Weighted average rate Receive %	Pay %	Estimated Fair Value €000
Interest rate derivatives designated as fair value hedges					
Receive fixed					
1 year or less					-
1-5 years					(55,608)
Over 5 years					(22,881)
	5,500,000	3.16	3.64		(78,489)
Pay floating					
1 year or less					
1-5 years					
Over 5 years					
	5,500,000	0.08		3.72	0
Other Interest rate derivatives*					
Interest rate swaps:					
Pay floating					
1 year or less					(124,692)
1-5 years					(85,130)
Over 5 years					(4,860)
	16,321,214	0.08		4.49	(214,682)
Receive floating					
1 year or less					201,783
1-5 years					-
Over 5 years					-
	16,321,214	0.08	4.51		201,783

* These swaps are used to hedge the mortgage loan portfolio but do not qualify for fair value hedge accounting.

AIB Mortgage Bank

Notes to the accounts

8. 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 lendings 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. These items are material and accordingly, the fair value information presented does not purport to represent, nor should it be construed to represent, the underlying value of the Bank as a going concern at 31 December 2006.

The following table gives details of the carrying amounts and fair values of financial instruments at 31 December 2006.

	2006	2006	2005	2005
	Carrying	Fair value	Carrying	Fair Value
	Amount	Amount	Amount	Amount
	€000	€000	€000	€000
Non trading				
Assets				
Cash and balances at central bank	25	25	-	-
Loans and receivables to banks	6,999,839	6,999,839	-	-
Loans and receivables to customers	16,312,425	16,304,789	-	-
Liabilities				
Deposits by banks	16,965,052	16,965,052	-	-
Customer accounts	1,047	1,047	-	-
Derivative financial instruments	91,388	91,388	-	-
Debt securities in issue	5,423,700	5,423,700	-	-
Subordinated liabilities	300,000	300,000	-	-

AIB Mortgage Bank

Notes to the accounts

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

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

Loans and receivables to banks and loans and receivables to customers

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

The Bank provides lending facilities of varying rates and maturities to corporate and personal customers. Valuation techniques including, using recent arm's length market transactions; reference to fair value of another similar instrument; discounted cash flow analysis; and option pricing models are employed, as considered appropriate, in estimating the fair value of loans. Where secondary market prices were available, they were used. The carrying amount of variable rate loans was considered to be at market value if there was no significant change in the credit risk of the borrower. The fair value of fixed rate loans was calculated by discounting expected cash flows using discount rates that reflected the credit and interest rate risk in the portfolio.

Deposits by banks, customer accounts and debt securities in issue

The fair value of deposits by banks and customer accounts is equal to their book value. The fair value of debt securities in issue is estimated using discounted cash flows applying either market rates, where applicable, or interest rates currently offered by AIB.

Subordinated liabilities

The estimated fair value of subordinated liabilities is equal to their book value. In all cases, redemption prior to maturity is subject to the necessary prior approval of the Central Bank and Financial Services Regulatory Authority 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 for valuing similar instruments used for trading purposes.

AIB Mortgage Bank

Notes to the accounts

	31 Dec 2006 €000	31 Dec 2005 €000
9. Loans and receivables to banks		
<hr/>		
Funds placed with Allied Irish Banks, p.l.c.		
Analysed by remaining maturity:		
- 3 months or less	1,499,839	40
- 1 year or less but over 3 months	-	-
- 5 years or less but over 1 year	4,500,000	-
- Greater than 5 years	1,000,000	-
	<hr/> 6,999,839	<hr/> 40

	31 Dec 2006 €000	31 Dec 2005 €000
10. Loans and receivables to customers		
<hr/>		
Analysed by remaining maturity:		
- 3 months or less	145,111	-
- 1 year or less but over 3 months	412,431	-
- 5 years or less but over 1 year	2,231,001	-
- Greater than 5 years	13,535,964	-
Provisions for impairment of loans and receivables (note 5)	(12,082)	-
	<hr/> 16,312,425	<hr/> -

Loans and receivables to customers comprise only the AIB branch originated residential mortgage loan portfolio in the Republic of Ireland. This portfolio contains high quality loans which are well diversified by borrower, by market segment and by geographical location.

AIB Mortgage Bank

Notes to the accounts

	31 Dec 2006 €000	31 Dec 2005 €000
11. Other assets		
Accrued interest	33,398	-
Other assets	155	-
	33,553	-

	31 Dec 2006 €000	31 Dec 2005 €000
12. Deposits by banks		
Due to Allied Irish Banks, p.l.c.	16,965,052	-
	16,965,052	-

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.

At 31 December 2006 there were no deposits by credit institutions that were secured on the Bank's obligations to the Central Bank and Financial Services Authority of Ireland under the terms of the Mortgage Backed Promissory Note ('MBPN') programme. Such deposits by credit institutions existed during the reporting period and these obligations were secured by way of a first floating charge to the CBFSAI over all its right, title, interest and benefit in loans and receivables to customers. Otherwise than with the prior written consent of the CBFSAI, the Bank had pledged under the terms of the floating charge to maintain the assets so charged free from any encumbrance and otherwise than in the ordinary course of business not to sell, transfer, lend or otherwise dispose of any part of the charged assets.

	31 Dec 2006 €000	31 Dec 2005 €000
13. Debt securities in issue		
Mortgage covered securities in issue by remaining maturity :		
- 5 years or less but over 1 year	4,444,978	-
- Greater than 5 years	978,722	-
	5,423,700	-

AIB Mortgage Bank

Notes to the accounts

13. Debt securities in issue (continued)

In April 2006 the Bank issued €2,500m in mortgage covered securities at a coupon rate of 3.5% maturing in April 2009 and €1,000m in mortgage covered securities at a coupon rate of 3.75% maturing in April 2013. In December 2006, it also issued €2,000m in mortgage covered securities at a coupon rate of 3.75% maturing in January 2010. The mortgage covered securities are shown on the balance sheet net of issue costs incurred in connection with the issue. The discount on issuance and the issue costs are amortised to the income statement over the life time of the instrument so that these are allocated to the accounting periods at a constant rate based on the carrying amount of the instrument.

AIB Mortgage Bank is an issuer of mortgage covered securities under the Asset Covered Securities Act, 2001 (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 2006, the Cover Assets Pool amounted to €8.7bn, comprising of €7.8bn of mortgage credit assets (mortgage loan accounts) and €0.9bn of substitution assets (cash). 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 as at 31 December 2006

Total Loan Balances From	To	Total Loan Balances (1 & 2) €m	Number of Mortgaged Properties
0	€100,000	919	18,452
€100,000	€200,000	2628	17,739
€200,000	€500,000	3393	12,102
Over €500,000		843	1,047
		7,783	49,340

(1) The total loan balances are per mortgaged property and represent the total 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 58,423 loan accounts secured on 49,340 properties.

13 (b) Geographical location of mortgaged properties in the Cover Assets Pool as at 31 December 2006

Geographical Area	Number of Mortgaged Properties	
Co. Dublin	10,804	22%
Outside Dublin	38,536	78%
	49,340	100%

AIB Mortgage Bank

Notes to the accounts

13. Debt securities in issue *(continued)*

13 (c) Mortgage loan accounts in default in the Cover Assets Pool as at 31 December 2006

As at 31 December 2006, there were no mortgage loan accounts in default in the Cover Assets Pool (in default being defined as mortgage loan accounts in arrears by three months or more).

13 (d) Mortgage loan accounts in default in the Cover Assets Pool with arrears greater than €1,000 as at 31 December 2006

During the year ended 31 December 2006, 45 mortgage loan accounts in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2006, there were no accounts in default in the Cover Assets Pool.

13 (e) Replacement of non-performing mortgage loan accounts from the Cover Assets Pool during the year ended 31 December 2006

During the year ended 31 December 2006, 273 non-performing mortgage loan accounts were removed in total from the Cover Assets Pool. (For this purpose, non-performing is defined as in arrears by three months or more, i.e. has the same meaning as in default.) These loan accounts were not (immediately) 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 as at 31 December 2006

The total amount in arrears (including principal and interest) in respect of the 37 accounts in arrears as at 31 December 2006 was €243,187. None of the accounts in question were written off as at 31 December 2006, as they were in arrears by less than three months.

13 (g) Total principal and interest payments on mortgage loan accounts for the year ended 31 December 2006

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 2006 was €1,040m, of which €873m represented repayment of principal and €167m 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 as at 31 December 2006 secured on commercial property

As at 31 December 2006 there were no loan accounts in the Cover Assets Pool that were secured on commercial properties.

AIB Mortgage Bank

Notes to the accounts

	31 Dec 2006 €000	31 Dec 2005 €000
14. Accruals and deferred income		
Interest payable on mortgage covered securities	96,610	-
Expenses	547	-
	97,157	-

	31 Dec 2006 €000	31 Dec 2005 €000
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15. Subordinated liabilities

The estimated fair value of subordinated liabilities is considered equal to the carrying value.

	31 Dec 2006 €000	31 Dec 2005 €000
Dated Capital Note	100,000	-
Perpetual Capital Note	200,000	-
	300,000	-

- (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. The Note with interest payable monthly in arrears 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 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. The Note with interest payable monthly in arrears 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.

AIB Mortgage Bank

Notes to the accounts

	31 Dec 2006 €000	31 Dec 2005 €000
16. Share capital		
Authorised: 1,000,000,000 ordinary shares of €1.00 each	<u>1,000,000</u>	<u>1,000,000</u>
Issued and fully paid: 405,000,000 ordinary shares of €1.00 each	<u>405,000</u>	<u>40</u>
Movements in issued share capital:		
At 1 January	40	-
New shares issued during the year	404,960	40
At 31 December	405,000	40

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. Employee Information

For the year ended 31 December 2006 the average number of employees was 5 (2005: nil). As at 31 December 2006, there were 6 employees of the Bank.

	31 Dec 2006 €000	31 Dec 2005 €000
18. Statement of cash flow		
Loans and receivables to Allied Irish Banks, p.l.c.	56,897	40
Cash and cash equivalents	56,897	40

"Cash and Cash Equivalents" are part of loans and receivables to banks in the balance sheet on Page 18.

AIB Mortgage Bank

Notes to the accounts

	31 Dec 2006 €000	31 Dec 2005 €000
19. Auditors' remuneration		
Auditors' remuneration		
Statutory audit	50	-
Audit related services	5	-
Total auditors' remuneration	55	-

Audit related services include fees for assignments which are of an audit nature.

	31 Dec 2006 €000	31 Dec 2005 €000
20. Directors' remuneration		
Fees	53	-
	53	-

21. Reporting currency

The currency used in these accounts is euro which is denoted by 'EUR' or the symbol '€'.

22. Contingent liabilities and commitments

There were no contingent liabilities or assets at 31 December 2006 that would require disclosure under IAS 37.

At 31 December 2006 the Bank had €1,084m (2005:nil) of approved mortgage loan applications that had not been drawn down as at the year end.

AIB Mortgage Bank

Notes to the accounts

23. 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 at an arms length basis. Interest Paid to AIB and interest received from AIB are disclosed in Note 1 and Note 2.

Most of the Bank’s activities are outsourced to Allied Irish Banks, p.l.c. under an Outsourcing and Agency Agreement. Allied Irish Banks, p.l.c., as Service Agent for the Bank, originates residential mortgage loans through its retail branch network 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 Allied Irish Banks, p.l.c..

(b) Loans to Directors and Other Senior Executive Officers

Loans to non-executive Directors are made in the ordinary course of business on normal commercial terms. Loans to executive Directors and staff are made (i) by the parent company on terms applicable to other employees of the parent company, in accordance with established policy, within limits set on a case by case basis, and/or (ii) otherwise, on normal commercial terms. The following amounts in respect of one Director were outstanding at 31 December 2006.

	31 Dec 2006 €000	31 Dec 2005 €000
Amount	1,198	-
Number of persons	1	-

24. Post balance sheet events

There have been no material post-balance sheet events which would require disclosure or adjustment to the 31 December 2006 Financial Statements.

25. Approval of financial statements

The financial statements were approved by the Directors on 30 March 2007.