

# **AIB MORTGAGE BANK**

**DIRECTORS' REPORT AND ANNUAL FINANCIAL STATEMENTS**  
**For the financial year ended 31 December 2015**

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**DIRECTORS' AND OTHER INFORMATION****DIRECTORS**

Dave Keenan	Group Non-Executive Director and Chairman
Jim O'Keeffe	Executive Director (Managing)
Gerry Gaffney	Executive Director
James Murphy	Group Non-Executive Director
Catherine Woods	Independent Non-Executive Director

**SECRETARY** Louise Cleary

**REGISTERED OFFICE** Bankcentre  
Ballsbridge  
Dublin 4  
Ireland

**REGISTERED NUMBER** 404926

**REGISTERED AUDITOR** Deloitte  
Chartered Accountants & Statutory Audit Firm  
Hardwicke House  
Hatch Street  
Dublin 2  
Ireland

**BANKER** Allied Irish Banks, p.l.c.

**SOLICITOR** Helen Dooley  
Group General Counsel  
Allied Irish Banks, p.l.c.  
Bankcentre  
Ballsbridge  
Dublin 4  
Ireland

**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 financial year ended 31 December 2015. The Directors' Responsibility Statement in relation to the financial statements appears on page 37.

**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'). AIB Group and its subsidiaries, including AIBMB, came under the direct supervision of, and are deemed to be authorised by the European Central Bank ('ECB') since the introduction on 4 November 2014 of the Single Supervisory Mechanism ('SSM'). The SSM places the ECB as the central prudential supervisor of financial institutions in the Eurozone, including AIB and its subsidiaries. The Bank continues to be supervised by the Central Bank of Ireland for non-prudential matters, including, consumer protection and the combat of money laundering.

The Bank's 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 (MBPN) facility between AIB Mortgage Bank and the Central Bank 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 issuances since that date. The Programme was subsequently increased to €20bn in 2009.

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, amounting to approximately €4.2 billion. The transfer was effected pursuant to the statutory transfer mechanism provided for in the Asset Covered Securities Acts. With effect from September 2014, AIB decided that all new lending through mortgage intermediaries would be completed by Haven Mortgages Limited, a business which is dedicated to serving the mortgage intermediary market.

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 with the balance of funding being provided by AIB Group. The Bank is also party to the MBPN agreements with the Central Bank of Ireland, however this type of funding has not been utilised since 2011.

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 other distribution channels in the Republic of Ireland, services the mortgage loans, and provides treasury services in connection with financing as well as a range of other support services.

**Corporate governance statement***The Board of Directors*

The Board is responsible for corporate governance encompassing leadership, direction and control of the Bank and is responsible for financial performance to its shareholder and parent AIB. Governance is exercised through a Board of Directors ("the Board") and a senior management team. The conditions of the Bank's Central Bank licence require that there should be a minimum of two Non-Executive Directors who are independent of the parent company. Throughout 2015, there were two independent Non-Executive Directors on the Board of the Bank. With effect from 31 December 2015, Eileen Kelliher resigned as a Non-Executive Director of the Board. The Board also included two Executive Directors, both of whom were directly involved in the operation of AIB Mortgage Bank, and two other Directors who, while also employees of AIB, were deemed to be Non-Executive Directors by virtue of the roles they fulfilled in areas of AIB Group unrelated to the operations of AIB Mortgage Bank.

The Board is responsible for ensuring that appropriate systems of internal controls and risk management are maintained, specifically the Board sets the Risk Appetite Statement, approves the Risk Framework and approves the annual financial plans. The Bank benefits as a subsidiary of AIB from the wider AIB Group governance and operating structure, including in relation to oversight of audit and risk related activities. AIB provide services to AIB Mortgage Bank through a formal managed services agreement, updates in respect of the performance against which are provided to the Board regularly. In the event that material failings or weaknesses in the systems of risk management or internal control are identified, explanation of the issue is present with proposed remediation plan to the Board. Agreed remediation plans are tracked to conclusion, with status updates provided to the Board. Given the work of the Board and representations made by the Management Team during the year, the Board is satisfied that the necessary actions to address any material failings or weaknesses identified through the operation of the risk management and internal control framework have been taken, or are currently being undertaken. In addition, the Board has considered the identification in 2015 of failings that originated in prior years that require customer redress. Taking this and all other information into consideration as outlined above, the Board is satisfied that there has been an effective system of control in place throughout the year.

The Board receives regular updates on the Bank's risk profile through the quarterly report together with relevant updates from the Board Audit Committee. The Board held 4 scheduled meetings during 2015.

*Board Committees*

The Board is assisted in the discharge of its duties by an Audit Committee which operates under Terms of Reference approved by the Board. The Audit Committee comprises Non-Executive Directors whom the Board has determined have the collective skills and relevant financial experience to enable the Committee to discharge its responsibilities. The Audit Committee has oversight responsibility for:

- the quality and integrity of the Bank's accounting policies, financial statements and disclosure practices;
- compliance with relevant laws, regulations, codes of conduct and "conduct of business" rules;
- the independence and performance of the External Auditor ("the Auditor") and Internal Audit; and
- the adequacy and performance of systems of internal control and the management of financial and non-financial risks.

**DIRECTORS' REPORT (CONTINUED)****Corporate governance statement (continued)**

These responsibilities are discharged through its meetings with and receipt of reports from the Auditor and management including Finance, Internal Audit, Risk and Compliance. During 2015 the Committee met on 4 occasions and amongst other activities the Committee reviewed the Bank's annual financial statements prior to approval by the Board, including the Bank's accounting policies and practices; reports on compliance; effectiveness of internal controls; including the effectiveness of controls operated under the MSA; and the findings, conclusions and recommendations of the Auditor and Internal Auditor. The Committee satisfied itself through regular reports from the Internal Auditor, Risk, Compliance and the Auditor that the system of internal controls were effective. The Committee ensures that appropriate measures are taken to consider and address any control issues identified by Internal Audit and the Auditor. The Committee members during the year were: Catherine Woods, James Murphy and Eileen Kelliher (until 31 December 2015).

AIB Mortgage Bank ("the Bank") is subject to the provisions of the Central Bank of Ireland's ("Central Bank") Corporate Governance Code for Credit Institutions and Insurance Undertakings ("the 2010 Code") (which is available on [www.centralbank.ie](http://www.centralbank.ie)), which imposes minimum core standards upon all credit institutions and insurance undertakings licensed or authorised by the Central Bank of Ireland. The Directors believe that the Bank materially complied with the provisions of the 2010 Code throughout 2015.

During December 2015, the Central Bank published revised Corporate Governance Requirements for Credit Institutions 2015 ("the 2015 Requirements") (which are available on [www.centralbank.ie](http://www.centralbank.ie)) which became effective for all credit institutions on 11 January 2016. During December 2015, the Central Bank notified the Bank that the 2015 Requirements would be imposed as a condition on its Central Bank banking license. They further advised that, under the 2015 Requirements, the Bank was designated as a "high impact institution" which resulted in a number of significant incremental obligations for which the Bank sought and subsequently received derogations. Following Eileen Kelliher's resignation from the Bank with effect from 31 December 2015, the Bank was not in compliance with certain provisions of the 2015 Requirements. This will be reported in the Bank's Annual Compliance Statement for 2016. The Bank has notified the Central Bank of Ms. Kelliher's resignation and action to address the composition of the Board of Directors is under review.

The Bank's corporate governance practices are designed to ensure compliance with applicable legal and regulatory requirements including, Irish company law and the Listing Rules applicable to debt listings of the Main Securities Market of the Irish Stock Exchange.

The Bank believes it has robust governance arrangements, which include a clear organisational structure with well defined, transparent, and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate internal controls, including sound administrative and accounting procedures, IT systems and controls.

**Business review**

The Irish economy improved generally during 2015 including a decreasing unemployment rate standing at 8.8% at the end of December 2015 against a peak of 12.1% in 2014 (Source: Central Statistics Office) and decreasing mortgage arrears. Total market mortgage drawdowns in Ireland were €4.9bn in 2015 compared with €3.9bn in 2014. Throughout 2015 there was increased competition in the mortgage market with new entrants and with competitors offering incentives to new borrowers.

The CSO Residential Property Price Index showed an increase in prices nationally of 6.6% in the 12 months to December 2015 (16.3% in 2014). This was particularly evident outside Dublin where the 2015 annual increase was 10.2% (December 2014 10.2%). Property prices in Dublin increased in the 12 month period by 2.6% (increase of 22.3% in 2014). The national fall from peak property prices (February 2007) was 33.5% at December 2015 (37.6% at December 2014).

The Bank continues to provide highly competitive home loans in the Irish market, offering a range of fixed and variable rates and channel options including Branch and Online. The Bank's main focus is to support viable owner-occupier and buy-to-let residential customers, including First Time Buyers, Home Movers, Home Improvements and those switching their mortgage to the Bank.

The Bank's loan portfolio before provisions decreased by 6% during 2015 to €20.5bn as at 31 December 2015 principally because repayments and write offs exceeded loans granted during the year (2014: decrease of 5%).

At 31 December 2015, AIB Mortgage Bank mortgage loans of €20.5bn (2014: €21.9bn) accounted for 56% (2014: 56%) of the AIB Group's residential mortgage portfolio of €36.8bn (2014: €38.8bn).

AIB Mortgage Bank's residential mortgage portfolio comprises €15.8bn owner occupier (2014: €16.2bn) and €4.7bn buy-to-let mortgages (2014: €5.7bn). The owner occupier portfolio is comprised of 43% ECB tracker (2014: 45%), 44% variable interest rate (2014: 45%) and 13% fixed rate mortgage loans (2014: 10%). Interest only loans represent 1% of the owner occupier portfolio (2014: 2%). The buy-to-let portfolio is comprised of 61% ECB tracker (2014: 62%), 38% are on variable interest rates (2014: 37%) and 1% are fixed (2014: 1%). Interest only loans make up 10% of the buy-to-let portfolio (2014: 9%).

As a result of positive trends in the Irish economy, including an improving residential property market and decreasing unemployment, leading to an improvement in asset values, borrower repayment capacity, loan restructures and write-offs, the Bank's impaired loans have decreased to €2.9bn, or 14% of total loans (2014: €4.6bn or 20.9%).

**Mortgage Arrears Resolution Strategy**

AIB has developed a Mortgage Arrears Resolution Strategy ('MARS') which builds on and formalises AIB Group's Mortgage Arrears Resolution Process, to implement the Codes of Conduct as set out by the Central Bank of Ireland, for dealing in a professional and timely manner with mortgage customers in difficulty or likely to be in difficulty. The core objectives of MARS are to ensure that arrears solutions are sustainable in the long-term and that they comply with the spirit and the letter of all regulatory requirements. MARS includes long-term forbearance solutions which have been devised to assist existing primary residential mortgage customers in difficulty.

At 31 December 2015, there were forbearance solutions in place on circa 17k accounts with loan balances of €3.0bn (2014: circa 17k accounts with €3.3bn balance). The stock of loans subject to forbearance measures decreased by €271m in 2015 (2014: decrease of €131m) due to the expiry of short-term forbearance arrangements (e.g. periods of interest only or fixed repayments) which were not matched by new arrangements in the period. During 2015 there was a migration from short term to longer term sustainable forbearance solutions in particular a reduction in loan balances on interest only of €221m, reduced payment facility of €120m with decrease in arrears capitalisations of €219m offset by increase in fundamental restructures €184m, increase in split mortgage of €46m and positive equity solution of €67m.

**DIRECTORS' REPORT (CONTINUED)****Results for the year**

AIB Mortgage Bank generated a profit before taxation for 2015 of €615m, compared to €416m in 2014. Increased profitability is due to a release of provisions for impaired loans against the income statement, and higher net interest income. Profit after tax of €538m was added to Shareholders' Equity in 2015 compared to €364m in 2014.

The Bank's particular focus is on New Lending and Net Interest Margin. During 2015 the Bank advanced new lending of €1,039m which was a significant increase on 2014's figure of €764m. The bank introduced lower and more competitive fixed and variable rates which contributed to the increase in drawdowns.

**Net Interest Income/ Margin**

Net interest income increased to €451m (2014: €376m) This improvement was driven by lower funding costs of €212m (2014: €293m) offset by lower interest income of €663m (2014: €669m) due to reductions in fixed and variable rates in May, June and October and lower average loan balances. The net interest margin for 2015 was 2.13%, an increase of 0.48% compared to 1.65% for 2014.

**Administration Expenses**

Administrative expenses increased by €100m to €161m during the year due to the recording of a provision of €97m for customers redress and other matters relating to a request from the Central Bank of Ireland ("CBI") in December 2015, to the Irish banking industry, including AIB, to conduct a broad examination of tracker mortgage related issues.

**Provisions Writeback**

Overall provision writeback for 2015 of €323m compared to €100m in 2014, an increase in provision writeback of €223m. Specific impairment provision release has increased by €84m in 2015, arising from a substantial reduction in the level of newly impaired loans, an improvement in economic conditions and the impact of arrears management activities. The Incurred But Not Reported ("IBNR") stock levels have been reduced in 2015, resulting in a writeback of €158m (2014: €19m) due to an updated AIB private dwelling model implemented for provisioning. Specific provision stock amounts to €957m (2014: €1,641m) and IBNR provisions stand at €152m (2014: €310m) as at 31 December 2015.

**Funding activities**

AIB Mortgage Bank (AIBMB) issued two benchmark covered bonds in 2015, raising a total of €1.5bn in funding. These trades took advantage of a favourable market backdrop for covered bonds in 2015, where the ECB's covered bond purchase programme (CBPP3) was actively buying bonds in both the primary and secondary markets. CBPP3 is aimed at enhancing the functioning of the monetary policy transmission mechanism, supporting financing conditions in the euro area, facilitating credit provision to the real economy.

In January 2015 the ECB announced an expanded asset purchase programme aimed at fulfilling the ECB's price stability mandate by adding a public sector purchase programme for government bonds to the existing private sector programmes for covered bonds and Asset Backed Securities. AIBMB capitalised on the favourable market reaction to that announcement by launching a new €750m 7 year Asset Covered Securities (ACS) in February 2015, attracting circa €2.5bn in demand from 125 investors to achieve final pricing at mid-swaps plus 27 basis points, equating to a re-offer yield of 0.748%. This compared very favourably with the March 2014 €500m 7 year ACS, which priced at mid-swaps plus 95 basis points, reflecting the strong spread performance of ACS over that period.

In July 2015 AIBMB returned to the ACS market, launching and pricing a highly successful new 5-year €750m ACS at mid-swaps plus 22bps, a re-offer yield of 0.663%. This deal achieved a final book size of circa €1.3bn from 80 investors.

Both deals attracted strong demand from Germany, with 42% of the 7 year and 49% of the 5 year allocated to German accounts. Asset Managers accounted for the largest investor segment with 52% and 59% of the 7 year and 5 year respectively allocated to that sector, ahead of the bank and insurance/pension fund sectors. Distribution to Central Banks/Official Institutions was 16% in the 7 year and 22% in the 5 year, which includes the participation of CBPP3 via the ECB and Central Bank of Ireland.

Towards the latter part of 2015 covered bond spreads saw some widening, driven by a mixture of elevated supply in the asset class and declining secondary market liquidity, among other factors. This spread widening was reflected in AIBMB spreads, with the 5 and 7 year trades ending the year at swaps plus 27 and 30 basis points respectively, both trading somewhat wider than the reoffer spreads on the bonds at launch.

At 31 December 2015, the total amount of principal outstanding in respect of mortgage covered securities issued was €7.2bn (31 December 2014: €7.7bn), of which €4.8bn was held by external debt investors (31 December 2014: €3.8bn), €1.2bn by Allied Irish Banks, p.l.c. (31 December 2014: €1.2bn) and €1.2bn was self-issued to AIB Mortgage Bank (31 December 2014: €2.8bn).

AIB Mortgage Bank benefited from several ratings upgrades during 2015, driven by a number of factors including changes in Rating Agency methodology and improvements in the Allied Irish Banks, p.l.c. ratings during the year. Moody's upgraded AIBMB from A3 to Aa2 in May and to Aa1 in November 2015. S&P upgraded AIBMB on several occasions, from A to A+ in March, to AA- on July 10th followed by AA on July 23rd and finally to AA+ in December. Fitch initially downgraded the bonds to A- from A in May before restoring the A rating in September and upgrading to A+ in December.

## DIRECTORS' REPORT (CONTINUED)

## Funding activities (continued)

The ratings as at 8 February 2016, for the Bank's Covered Bond Programme, Allied Irish Banks, p.l.c. 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+	BB+	A
Moody's	Aa1	Ba1	Baa1
Standard & Poor's	AA+	BB+	A+

## Share Capital

The share capital of the Bank is €1,745m (2014: €1,745m), comprised of ordinary shares of €1 each.

## Capital resources and regulatory capital ratios

The table below shows the components of the AIB Mortgage Bank's Common equity Tier 1 and Total capital ratios as at 31 December 2015 and 31 December 2014.

	CRD IV Transitional basis	
	31 December 2015	31 December 2014
	€m	€m
Core tier 1/common equity tier 1 capital	1,928	1,405
Tier 2 capital		
Total Tier 2 capital	301	368
Total capital	2,229	1,773
Risk Weighted Assets	9,942	11,251
Core tier 1/common equity tier 1 ratio	19.4%	12.5%
Total capital ratio	22.4%	15.8%

Under the fully loaded CRD IV capital basis the impact of the deduction of the deferred tax asset reduces the Total Capital ratio by 0.7%.

## Outlook

The capital position of the Bank is stable due to an increase in profitability and the ongoing commitment of support from AIB. AIB Mortgage Bank is sufficiently capitalised to meet its regulatory requirements.

## Risk Management

The risk management framework provides a firm-wide definition of risk and lays down principles of how risk is to be identified, assessed, measured, monitored and controlled / mitigated, and the associated allocation of capital against same. Further information in relation to the Risk Management are set out in the Risk Management Report on pages 9 to 36. The principal risks and uncertainties facing AIBMB are declared in AIB Group's Annual Financial Report.

## Going concern

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

AIB Mortgage Bank is dependent on its parent, Allied Irish Banks, and p.l.c. for continued funding and is therefore dependent on the going concern status of the parent.

The financial statements of Allied Irish Banks p.l.c. have been prepared on a going concern basis. In making its assessment, the Directors of AIB Group have considered a wide range of information relating to present and future conditions. These have included financial plans approved by the Board of AIB Group in December 2015 covering the period 2016 to 2018, the Restructuring Plan approved by the European Commission in May 2014, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios. In addition, the Directors of AIB Group have considered the outlook for the Irish, the eurozone and UK economies and the factors and uncertainties impacting their performance.

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 believe that it is appropriate to prepare the financial statements on a going concern basis.

## DIRECTORS' REPORT (CONTINUED)

## Directors' and Secretary's interests in shares

The beneficial interests of the Directors and the Secretary in office at 31 December 2015 and of their spouses and minor children in the share capital or debentures of the parent company, Allied Irish Banks, p.l.c. ("AIB") were less than 1% of the nominal value of AIB's issued share capital as at 1 January and 31 December 2015 and are not required to be disclosed in accordance with the Companies Act 2014.

## Share options note

Details of the Directors' and the Secretary's options to subscribe for ordinary shares in Allied Irish Banks, p.l.c., are given below. Details are shown in the Register of Directors' and Secretary's Interests, which may be inspected at the Bank's registered office. Options were last granted under this Scheme in 2005. This scheme was terminated in April 2015 with all outstanding options either being forfeited or lapsed.

	31 December 2015	1 January 2015	Options lapsed during 2015	Weighted Average subscriptions price of options outstanding at 31 December 2015 €
<b>Directors:</b>				
Dave Keenan	Nil	Nil	Nil	Nil
Gerry Gaffney	Nil	Nil	Nil	Nil
James Murphy	Nil	5,000	5,000	16.20
Jim O'Keeffe	Nil	10,000	10,000	16.20
<b>Secretary:</b>				
Louise Cleary	Nil	Nil	Nil	Nil

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

## 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 2015. 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 2015 and 15 March 2016.

## Attendance at scheduled Board and Board Committee Meetings

Name	Board		Board Audit Committee	
	A	B	A	B
<b>Directors</b>				
Dave Keenan	4	4	-	-
Jim O'Keeffe	4	4	-	-
Catherine Woods	4	4	4	4
James Murphy	4	4	4	4
Gerry Gaffney	4	3		
Eileen Kelliher	4	4	4	4

Column A indicates the number of scheduled meetings held during 2015 which the Director was eligible to attend; Column B indicates the number of meetings attended by each Director during 2015.

## Directors and Secretary

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

Mr David Schorman resigned as Secretary on 18 March 2015.

Ms Louise Cleary was appointed Secretary on 18 March 2015.

Ms Eileen Kelliher resigned as a Non-executive director on 31 December 2015.

## Adequate Accounting Records

The Directors believe that they have complied with the requirements of Section 281 to 285 of the Companies Act, 2014 with regard to adequate accounting records by allocating personnel with appropriate expertise and by providing adequate resources to the financial function under the Outsourcing and Agency Agreement for the provision of various services including accounting and other financial services to AIBMB by AIB p.l.c.. The accounting records of the Company are maintained at the registered office of its parent at AIB, Bankcentre, Ballsbridge, Dublin 4.



**DIRECTORS' REPORT (CONTINUED)**

**Events since the year end**

AIBMB issued new 7 year Asset Covered Securities on 4 February 2016 at a coupon of 0.875% per annum fixed at a net price of 99.441%. The proceeds were utilised to reduce the borrowings from AIB p.l.c.

**Independent auditor**

Deloitte, Chartered Accountants and Statutory Audit Firm, have expressed their willingness to continue in office under Section 383(2) of the Companies Act, 2014.

**On behalf of the Board**



Dave Keenan  
*Chairman*



Jim O'Keefe  
*Managing Director*

*Date: 15 March 2016*

**RISK MANAGEMENT REPORT****1. Introduction**

All of the Bank's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed 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 AIB Group's risk management framework. The principal risks and uncertainties facing AIB Group are discussed on pages 50 to 59 of the Group's Annual Financial Report 2015.

**2. Risk management framework**

AIB Mortgage Bank relies on the Group framework and its supporting policies, processes and governance. The AIB Group risk management framework is described on pages 60 to 62 of the Group's Annual Financial Report 2015. For more information on the operation of the Board of the Mortgage Bank and its Audit Committee see pages 3 to 4 of this report.

**3. Individual risk types**

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

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

The 6 applicable risk types are discussed overleaf.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk

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

Credit risk management objectives are to:

- Establish and maintain a control framework to ensure credit risk taking is based on sound credit management principles;
- Control and plan credit risk taking in line with external stakeholder expectations;
- Identify, assess and measure credit risk clearly and accurately across the Bank, from the level of individual facilities up to the total portfolio; and
- Monitor credit risk and adherence to agreed controls.

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.

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

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

## Maximum exposure to credit risk\*

	Amortised Cost	Fair Value	2015 Total	Amortised Cost	Fair Value	2014 Total
	€ m	€ m	€ m	€ m	€ m	€ m
Derivative financial instruments	-	249	249	-	329	329
Loans and receivables to banks	409	-	409	469	-	469
Loans and receivables to customers	19,371	-	19,371	19,920	-	19,920
Included elsewhere:						
Accrued interest	47	-	47	44	-	44
Other assets	6	-	6	5	-	5
	19,833	249	20,082	20,438	329	20,767
Off balance sheet loan commitments	394	-	394	349	-	349
Maximum exposure to credit risk	20,227	249	20,476	20,787	329	21,116

**Credit risk organisation and structure**

The AIB Group's credit risk management systems operate through a hierarchy of lending authorities. The Bank relies on the AIB Group credit risk framework and its supporting policies, processes and governance. All customer mortgage applications are subject to an individual credit assessment process.

The role of the AIB Group ("Group") Credit Risk function is to provide direction, oversight and challenge of credit risk-taking. The Bank's Risk Appetite Statements sets out the credit risk appetite and framework. Credit Risk appetite is set at Board level and is described, reported and monitored through a suit of metrics, supported by credit risk policies, concentration limits to manage risk and exposure within the Bank's approved risk appetite. The Bank's risk appetite for credit risk is reviewed and approved annually.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Measurement of credit risk**

One of the objectives of credit risk management is to accurately quantify the level of credit risk to which the Bank is exposed. The use of internal credit rating models is fundamental in assessing the credit quality of loan exposures, with variants of these used for the calculation of regulatory capital.

The primary model measures used are:

- Probability of default ("PD") – the likelihood that a borrower is unable to repay his obligations;
- Exposure at default ("EAD") – the exposure to a borrower who is unable to repay his obligations at the point of default;
- Loss given default ("LGD") – the loss associated with a defaulted loan or borrower, and;
- Expected loss ("EL") – the loss that can be incurred as a result of lending to a borrower that may default. It is the average expected loss in value over a specified period.

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

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

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

Credit grading and scoring systems facilitate the early identification and management of any deterioration in loan quality. Changes in the objective information are reflected in the credit grade of the borrower with the resultant grade influencing the management of individual loans. Special attention is paid to lower quality performing loans or 'criticised' loans. In AIB, criticised loans include 'watch', 'vulnerable' and 'impaired' loans which are defined as follows:

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

The Bank's criticised loans are subject to more intense assessments and reviews because of the increased risk associated with them.

Credit management and credit risk management continue to be key areas of focus. Resourcing, structures, policy and processes are subjected to on-going review in order to ensure that the Bank is best placed to manage asset quality and assist borrowers in line with agreed treatment strategies.

**Risk management and mitigation**

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

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

**Collateral**

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

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

Collateral valuations are required at the time of origination of each residential mortgage. The Bank adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of collateral. The fair value at 31 December 2015 is based on property values at origination or date of latest valuation and applying the Central Statistics Office ("CSO") Residential Property Price index (Republic of Ireland) to these values to take account of price movements in the interim.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Forbearance strategies\***

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

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

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

The Group 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 Group's Mortgage Arrears Resolution Process ("MARP").

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:

**Low fixed interest rate sustainable solution** – This solution is to support customers who have an income (and can afford a mortgage), but the income is not currently sufficient to cover full capital and interest on their mortgage based on their current interest rate(s) and/or personal circumstances. Their current income is, however, sufficient to cover full capital and interest at a lower rate. It involves the customer being provided with a low fixed interest rate for an agreed period after which the customer will convert to the prevailing variable rate for the remainder of the term of the mortgage on the basis that there is currently a reasonable expectation that the customer's income and/or circumstances will improve over the period of the reduced rate. The customer must pay full capital and interest throughout;

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

**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. This may also include an element of debt-write off; and

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

Credit policies are in place which outline the principles and processes underpinning the Group's approach to mortgage forbearance, which AIBMB has adopted.

**Loan loss provisioning\***

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

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

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

It is Group's policy to provide for impairment promptly and consistently across the loan book. All business areas formally review and confirm the appropriateness of their provisioning methodologies and the adequacy of their impairment provisions on a quarterly basis. Loans are tested for impairment on receipt of a forbearance request and when accounts reach 90 days past due.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Loan loss provisioning (continued)\***

The following are triggers to prompt/guide case managers regarding the requirement to assess for impairment:

**Mortgage portfolio triggers**

- Deterioration in the debt service capacity;
- A material decrease in rents received on a buy-to-let property;
- Borrowers that are 90 days past due; and
- On receipt of a forbearance request.

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

- Loss of significant tenant/material reduction in rental income;
- Significant financial difficulty;
- Decrease in cash flow; and
- Loss of employment.
- Net worth; and
- Planned sale of property asset did not take place.

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

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

**Specific provisions**

Specific impairment provisions arise when the recovery of a specific loan or group of loans is in doubt based on impairment triggers as outlined above and an assessment that all the expected future cash flows either from the loan itself or from the associated collateral will not be sufficient to repay the loan. The amount of the specific impairment provision is the difference between the present value of 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.

The individually significant threshold is €1,000,000 by customer connection. The calculation of an impairment charge for loans below the 'significant' threshold is undertaken on a collective basis.

**Individually Significant ('IS') Mortgages**

All loans that are considered individually significant are assessed on a case-by-case basis throughout the year if there is any objective evidence that a loan may be impaired. Assessment is based on ability to pay and collateral value. Individually significant provisions are calculated using discounted cash flows for each exposure. The cash flows are determined with reference to the individual characteristics of each credit including an assessment of the cash flows that may arise from foreclosure less costs to sell in respect of obtaining and selling any associated collateral. The time period likely to be required to realise the collateral and receive the cash flows is taken into account in estimating the future cash flows and discounting these back to present value.

**Individually Insignificant ('II') Mortgages**

Provisioning is assessed on a collective basis to estimate losses for homogeneous groups of loans that are considered individually insignificant. This applies for customer connections less than €1,000,000.

The individually insignificant mortgage provisioning methodology applies to both owner-occupier and buy-to-let exposures.

Individually insignificant mortgage specific provisions are calculated using a collective and IBNR mortgage provisioning model. This methodology is based on the calculation of three possible resolution outcomes: cure; advanced forbearance with loss; and repossession (forced and voluntary), with different loss rates associated with each. The methodology is regularly reviewed and updated to reflect current data on loss history and portfolio development as well as incorporating additional loss parameters assessed on restructuring outcomes.

The model parameters were refined during the year based on an additional one year dataset.

Key model parameters at 31 December 2015 for owner-occupier mortgages are as follows: cure (6 %); and disposal forbearance (94%), (2014: cure 4% and disposal forbearance 96%).

The corresponding buy-to-let model parameters at 31 December 2015 are as follows: cure (3.5%) and disposal forbearance (96.5%), (2014: cure 0.5% and disposal forbearance 99.5%).

The cure rate parameter in the individually insignificant model reflects the percentage of loans which were impaired/defaulted but have exited impairment/default after a 12 month satisfactory performance and no loss to the Bank.

The modelled loss is calculated on a case by case basis by subtracting the net present value of the modelled recovery amount from the current loan balance. The model parameters are determined from observed data where possible. Where not directly observable, related measures are used to infer the parameter where possible; otherwise it is based on expert judgement. The relevant model parameters include: percentage of forced disposals; costs and time to dispose (voluntary and forced); house price fall from peak; loss rate on advanced forbearance; and haircut on sale (voluntary and forced).

The model parameters are reviewed at Group credit committee on a quarterly basis. The main parameter changes for the year ended 31 December were an increase in the haircut on disposal for both Dublin and outside Dublin in addition to the application of updated house price fall from peak parameters again for both Dublin and outside Dublin.

\*Forms an integral part of the audited financial statements

**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)***Loan loss provisioning (continued)\***Incurred But Not Reported Provisions (IBNR)*

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

IBNR provisions can only be recognised for incurred losses i.e. losses that are present in the portfolio at the reporting date and are not permitted for losses that are expected to happen as a result of likely future events. IBNR provisions are determined by reference to loss experience in the portfolio and to the credit environment at the reporting date.

IBNR provisions are maintained at levels that are deemed appropriate by management having considered and having taken into account:

- historical loss experience (loss emergence rates based on historic grade migration experience or probability of default) in portfolios of similar credit risk characteristics (for example, by sector, loan grade or product);
- the estimated period between impairment occurring and the loss being identified and evidenced by the establishment of an appropriate provision against the individual loan (emergence period);
- loss given default rates based on historical loan loss experience, adjusted for current observable data;
- management's experienced judgement as to whether current economic and credit conditions are such that the actual level of inherent losses at the balance sheet date is likely to be greater or less than that suggested by historical experience; and
- an assessment of higher risk portfolios, for example, non-impaired forbore mortgages and restructured loans.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Loan loss provisioning (continued)\*

The residential mortgage portfolio IBNR is calculated using the individually insignificant and IBNR mortgage model described above. The table below sets out the parameters used in the calculation of IBNR for the residential mortgages portfolio as at 31 December 2015 and 31 December 2014:

Grade	Owner-Occupier			Buy-to-let			2015
	Exposure	Average PD	Average LGD	Exposure	Average PD	Average LGD	
	€m	%	%	€m	%	%	
Good upper	6,127	0.2	16.5	901	0.7	16.2	
Good lower	5,598	0.6	17.8	914	2.1	20.2	
Watch	896	1.4	20.6	191	5.5	21.3	
Vulnerable	1,848	20.9	18.2	1,103	24.8	22.6	

The parameters for Cured and Forborne – Not impaired, are set out below. As a result, these sub-portfolios within the residential mortgages carry a higher level of IBNR:

Cured	533	32.0	18.8	372	34.7	24.6
Forborne – Not impaired	1,045	16.7	17.6	576	22.0	23.3

Grade	Owner-Occupier			Buy-to-let			2014
	Exposure	Average PD	Average LGD	Exposure	Average PD	Average LGD	
	€m	%	%	€m	%	%	
Good upper	5,644	0.3	17.9	853	0.3	14.6	
Good lower	5,922	2.0	19.4	1,113	2.5	18.5	
Watch	1,211	8.1	22.8	247	11.1	20.7	
Vulnerable	1,510	43.9	19.0	794	40.4	20.8	

The parameters for Cured and Forborne – Not impaired, are set out below. As a result, these sub-portfolios within the residential mortgages carry a higher level of IBNR:

Cured	261	56.4	18.0	184	54.7	21.2
Forborne – Not impaired	865	33.5	18.5	404	31.0	20.9

Average PD and LGD are based on the PDs and LGDs, weighted by the EAD for all owner-occupier and buy-to-let loans included in the Individually Insignificant /IBNR mortgage model. The mortgage provision model calculates individually insignificant specific provisions and IBNR run rate provisions. Any additional IBNR, where appropriate, determined by management judgement is applied at a portfolio level and is not included in the analysis above.

\*Forms an integral part of the audited financial statements



**RISK MANAGEMENT REPORT (CONTINUED)****3.1 Credit risk (continued)*****Loan loss provisioning (continued)\*******Emergence period***

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

Emergence periods are reflective of the characteristics of the particular portfolio. Emergence periods are estimated based on historic loan loss experience supported by back testing, and as appropriate individual case sampling.

Emergence periods are reviewed on at least an annual basis. At 31 December 2015, there was no change made to the emergence period for the mortgage portfolio (12 months).

***Approval Process***

The AIB Group operates an approval framework for impairment provisions which are approved, depending on amount, by various delegated authorities and referred to Area Credit Committee level as required. These committees are chaired by the Chief Credit Officer ("CCO") or alternative specified Chair as outlined in the terms of reference for Credit Committees, where the valuation/impairment is reviewed and challenged for appropriateness and adequacy. Impairments in excess of the segment authorities are approved by the Group Credit Committee and Board (where applicable). Segment impairments and provisions are ultimately reviewed by the Group Credit Committee as part of the quarterly process.

The valuation assumptions and approaches used in determining the impairment provisions required are documented and the resulting impairment provisions are reviewed and challenged as part of the approval process by segment and Group senior management.

***Write-offs***

When the prospect of recovering a loan, either partially or fully, does not improve, a point will come when it will be concluded that as there is no realistic prospect of recovery and the loan (and any related specific provision) will be written off. Where the loan is secured, the write-off will take account of receipt of the net realisable value of security held. Partial write offs may also occur when it is considered that there is no prospect for the recovery of the provisioned amount, for example when a loan enters the legal process. The provision is written off but the remaining reduced loan balance remains on the balance sheet as impaired. In addition, some write-offs may reflect restructuring activity agreed with customers who are subject to the terms of the agreement and satisfactory performance.

***Reversals of Impairment***

If the amount of an impairment loss decreased in a subsequent period, and the decrease can be related objectively to an event occurring after the impairment was recognised, the excess is written back by reducing the loan impairment provision amounts accordingly. The write back is recognised in the income statement.

***Impact of changes to key assumptions and estimates on the impairment provisions***

Management is required to exercise judgement in making assumptions and estimations when calculating loan impairment provisions on both individually and collectively assessed loans and receivables. A significant judgemental area is the calculation of individually insignificant and IBNR impairment provisions which are subject to estimation uncertainty.

The methods involve the use of historical information which is supplemented with significant management judgement to assess whether current economic and credit conditions are such that the actual level of inherent losses is likely to be greater or less than that suggested by historical experience. In normal circumstances, historical experience provides the most objective and relevant information from which to assess inherent loss within each portfolio, though sometimes it provides less relevant information about the inherent loss in a given portfolio at the balance sheet date. For example; when there have been changes in economic, regulatory or behavioural conditions which result in the most recent trends in portfolio risk factors being not fully reflected in the statistical models. In these circumstances, the risk factors are taken into account by adjusting the impairment provisions derived solely from historical loss experience.

Risk factors include loan portfolio growth, product mix, unemployment rates, bankruptcy trends, geographical concentrations, loan product features, economic conditions such as national and local trends in housing markets, the level of interest rates, portfolio seasoning, account management policies and practices, changes in laws and regulations, and other influences on customer payment patterns. The methodology and the assumptions used in calculating impairment losses are reviewed regularly in the light of differences between loss estimates and actual loss experience. For example; loss rates and the expected timing of future recoveries are benchmarked against actual outcomes where available to ensure they remain appropriate.

However, the exercise of judgement requires the use of assumptions which are highly subjective and very sensitive to the risk factors, in particular to changes in economic and credit conditions across a large number of geographical areas.

The key variables include house price fall from peak c. 41% Dublin and 42% non-Dublin which determines the collateral value supporting loans in the mortgage portfolio and cure rates (rates by which defaulted or delinquent accounts are assumed to return to performing status).

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Loan loss provisioning (continued)

## Impact of changes to key assumptions and estimates on the impairment provisions (continued)

Sensitivity to changes in estimates and assumptions are detailed below:

A 1% favourable change in the cure rate used for the collective mortgage provisions would result in a reduction in impairment provisions of 0.6% (blended rate of owner-occupier/buy-to-let) or c. €4 million.

The value of collateral is estimated by applying changes in house price indices to the original assessed value of the property. A 1% change in the house price fall from peak assumption used for the collective mortgage provisions for December 2015 is estimated to result in movements in provisions of c. €10.5 million.

A 1% move in the haircut for a Dublin sale would result in a change of €2.53 million in provisions, (€1.83m II and €0.7m IBNR). A 1% move in the haircut for a sale outside Dublin would result in a change of €6.58 million in provisions, (€5.19m II and €1.39m IBNR).

An increase in the assumed repossession rate of 1% for collective mortgage provisions would result in an increase in provisions of 0.17% (blended rate of owner-occupier/buy-to-let) of c. €4.5 million.

An IBNR provision is made for impairments that have been incurred but have not been separately identifiable at the balance sheet date. This provision is sensitive to changes in the time between the loss event and the date the impairment is specifically identified. This period is known as the loss emergence period. In the Bank's mortgage portfolio, the emergence period is currently 12 months; a decrease of one month in the loss emergence period in respect of the loan portfolio assessed would result in a decrease in provisions of c. €11 million.

## Individually impaired loans by geographic location and sector\*

	2015 € m	2014 € m
Republic of Ireland		
Home Mortgages	2,902	4,578
	2,902	4,578

## Provision cover table

	Impaired Loan Balance	Specific Provision	Specific Provision Cover %
Home mortgages – 31 December 2015	2,902	957	33
Home mortgages – 31 December 2014	4,578	1,641	36

The change in specific provision cover percentage is driven by more conservative estimates in the provision model plus a decrease in impaired loans during 2015 due to restructuring and write-offs of provisions

The following pages provide details of:

- Analysis of the owner occupier and buy-to-let portfolios by arrears and provisions;
- Asset quality of residential mortgages
- Fair value of residential mortgage collateral;
- Arrears profile of mortgages which were past due but not impaired;
- Arrears profile of mortgages which were impaired;
- Forbearance:
  - Owner occupier
  - Buy-to-let
  - Total;
- Possessions;
- Loan to value profile; and
- Origination profile.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

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

## Statement of financial position\*

	2015			2014		
	Owner-Occupier € m	Buy-to-Let € m	Total € m	Owner-Occupier € m	Buy-to-Let € m	Total € m
Total gross residential mortgages	15,787	4,693	20,480	16,173	5,698	21,871
In arrears (>30days past due) <sup>(1)</sup>	1,541	1,728	3,269	2,205	2,866	5,071
In arrears (>90 days past due) <sup>(1)</sup>	1,467	1,676	3,143	2,085	2,803	4,888
Of which impaired	1,318	1,584	2,902	1,887	2,691	4,578
Statement of financial position specific provisions	393	564	957	563	1,078	1,641
Statement of financial position IBNR provisions	84	68	152	222	88	310

<sup>(1)</sup> Includes all loans past due whether impaired or not.

Total impaired loans amounted to €2,902 million at 31 December 2015 (2014: €4,578 million), of which €1,305 million (2014: €2,865 million) was individually assessed for impairment and €1,597 million (2014: €1,713 million) was collectively assessed for impairment.

## Provision cover percentage\*

	2015			2014		
	Owner-Occupier %	Buy-to-Let %	Total %	Owner-Occupier %	Buy-to-Let %	Total %
Specific provisions as a % of impaired loans cover	29.8	35.6	33.0	29.8	40.1	35.8

Income statement <sup>(2)</sup>

	2015			2014		
	Owner-Occupier €m	Buy-to-Let €m	Total €m	Owner-Occupier €m	Buy-to-Let €m	Total €m
Income Statement: specific provisions	(77)	(88)	(165)	(39)	(42)	(81)
Income Statement: IBNR provisions	(138)	(20)	(158)	-	(19)	(19)
Total impairment provisions	(215)	(108)	(323)	(39)	(61)	(100)

<sup>(2)</sup>In the table above, writebacks of provisions are presented as a negative and charges presented as a positive.

## Asset quality of residential mortgages\*

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

	2015			2014		
	Owner-Occupier € m	Buy-to-Let € m	Total € m	Owner-Occupier € m	Buy-to-Let € m	Total € m
Satisfactory	11,726	1,815	13,541	11,565	1,966	13,531
Watch	896	191	1,087	1,211	247	1,458
Vulnerable	1,847	1,103	2,950	1,510	794	2,304
Impaired	1,318	1,584	2,902	1,887	2,691	4,578
Criticised	4,061	2,878	6,939	4,608	3,732	8,340
Gross mortgages	15,787	4,693	20,480	16,173	5,698	21,871
	%	%	%	%	%	%
Criticised loans as % of total mortgages	26	61	34	28	65	38
Impaired loans as % of total mortgages	8	34	14	12	47	21

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Collateral for the residential mortgage portfolio**

For residential mortgages, the Bank takes collateral in support of lending transactions for the purchase of residential property. Collateral valuations are required at the time of origination of each residential mortgage. The Bank adjusts open market property values to take account of the costs of realisation and any discount associated with the realisation of collateral. The fair value at 31 December 2015 is based on property values at origination or date of latest valuation and applying the CSO Residential Property Price index (Republic of Ireland) and indices to these values to take account of price movements in the interim.

**Loans and receivables to customers – residential mortgages\***

The following tables show the fair value of collateral held for residential mortgages at 31 December 2015 and 31 December 2014:

	2015			
	Neither past due nor impaired € m	Past due but not impaired € m	Impaired € m	Total € m
<b>Fully collateralised</b>				
Loan-to-value ratio:				
Less than 50%	4,513	159	296	4,968
50%-70%	4,318	147	365	4,830
71%-80%	2,359	54	245	2,658
81%-90%	1,971	59	266	2,296
91%-100%	1,343	48	307	1,698
	<b>14,504</b>	<b>467</b>	<b>1,479</b>	<b>16,450</b>
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	2,102	91	1,138	3,331
<b>Total collateral value</b>	<b>16,606</b>	<b>558</b>	<b>2,617</b>	<b>19,781</b>
<b>Gross residential mortgages</b>	<b>16,992</b>	<b>586</b>	<b>2,902</b>	<b>20,480</b>
Statement of Financial Position: specific provisions			(957)	(957)
Statement of Financial Position: IBNR provisions				(152)
<b>Net residential mortgages</b>			<b>1,945</b>	<b>19,371</b>

  

	2014			
	Neither past due nor impaired € m	Past due but not impaired € m	Impaired € m	Total € m
<b>Fully collateralised</b>				
Loan-to-value ratio:				
Less than 50%	3,762	179	281	4,222
50%-70%	3,704	145	422	4,271
71%-80%	1,965	74	300	2,339
81%-90%	1,957	65	374	2,396
91%-100%	1,449	55	370	1,874
	<b>12,837</b>	<b>518</b>	<b>1,747</b>	<b>15,102</b>
<b>Partially collateralised</b>				
Collateral value relating to loans over 100% LTV	3,124	160	2,016	5,300
<b>Total collateral value</b>	<b>15,961</b>	<b>678</b>	<b>3,763</b>	<b>20,402</b>
<b>Gross residential mortgages</b>	<b>16,577</b>	<b>716</b>	<b>4,578</b>	<b>21,871</b>
Statement of Financial Position: specific provisions			(1,641)	(1,641)
Statement of Financial Position: IBNR provisions				(310)
<b>Net residential mortgages</b>			<b>2,937</b>	<b>19,920</b>

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 (CONTINUED)

## 3.1 Credit risk (continued)

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

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

The following tables profile the residential mortgage portfolio that were past due but not impaired at 31 December 2015 and 31 December 2014:

	2015		Total € m
	Owner – Occupier € m	Buy-to-Let € m	
1 - 30 days	141	77	218
31 - 60 days	47	33	80
61 - 90 days	28	19	47
91 - 180 days	37	20	57
181 - 365 days	35	21	56
Over 365 days	78	50	128
<b>Total past due but not impaired</b>	<b>366</b>	<b>220</b>	<b>586</b>

  

	2014		Total € m
	Owner – Occupier € m	Buy-to-Let € m	
1 - 30 days	154	69	223
31 - 60 days	78	44	122
61 - 90 days	43	19	62
91 - 180 days	68	30	98
181 - 365 days	74	35	109
Over 365 days	56	46	102
<b>Total past due but not impaired</b>	<b>473</b>	<b>243</b>	<b>716</b>

**Arrears profile of mortgages which were impaired\***

The following tables profile the residential mortgage portfolio that were impaired at 31 December 2015 and 31 December 2014:

	2015		Total € m
	Owner – Occupier € m	Buy-to-Let € m	
Not past due	354	353	707
1 - 30 days	71	42	113
31 - 60 days	29	25	54
61 - 90 days	22	22	44
91 - 180 days	54	65	119
181 - 365 days	77	103	180
Over 365 days	711	974	1,685
<b>Total impaired</b>	<b>1,318</b>	<b>1,584</b>	<b>2,902</b>

  

	2014		Total € m
	Owner – Occupier € m	Buy-to-Let € m	
Not past due	458	561	1,019
1 - 30 days	81	81	162
31 - 60 days	46	59	105
61 - 90 days	37	55	92
91 - 180 days	110	147	257
181 - 365 days	212	308	520
Over 365 days	943	1,480	2,423
<b>Total impaired</b>	<b>1,887</b>	<b>2,691</b>	<b>4,578</b>

Impaired loans decreased by €1,676m during 2015 due to restructuring and write-offs of provisions. In addition the rate of new to impairment slowed significantly in 2015 in comparison to 2014, driven by an improved economic environment. Of the residential mortgage portfolio that was impaired at 31 December 2015, €707m or 24% was not past due (31 December 2014: €1,019m or 22%), of which €434m (31 December 2014: €589m) was subject to forbearance measures at 31 December 2015.

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

**Forbearance**

AIB has developed a Mortgage Arrears Resolution Strategy ('MARS') for dealing with mortgage customers in difficulty or likely to be in difficulty which builds on and formalises AIB Group's Mortgage Arrears Resolution process. The core objectives of MARS are to ensure that arrears solutions are sustainable in the long-term and that they comply with the spirit and the letter of all regulatory requirements. MARS includes long-term forbearance solutions which have been devised to assist existing primary residential mortgage customers in difficulty.

The following table analyses the movement in stock of loans subject to forbearance by (i) owner-occupier, (ii) buy-to-let and (iii) total residential mortgages at 31 December 2015 and 31 December 2014:

**Residential owner-occupier mortgages – subject to forbearance\***

	2015		2014	
	Number	Balance €m	Number	Balance €m
At 1 January	10,210	1,740	8,793	1,632
Additions	2,246	361	3,425	595
Expired arrangements	(1,750)	(295)	(1,905)	(341)
Payments	-	(92)	-	(99)
Interest	-	42	-	27
Closed accounts <sup>(1)</sup>	(302)	(32)	(65)	(9)
Advanced Forbearance Arrangements - Valuation Adjustments	-	(11)	-	-
Write-Offs <sup>(2)</sup>	(21)	(22)	-	-
Transfer from owner-occupier to buy-to-let	(5)	1	-	-
Other movements	-	-	(38)	(65)
<b>At 31 December</b>	<b>10,378</b>	<b>1,692</b>	<b>10,210</b>	<b>1,740</b>

**Buy-to-let mortgages – subject to forbearance\***

	2015		2014	
	Number	Balance €m	Number	Balance €m
At 1 January	7,145	1,528	7,515	1,767
Additions	1,663	251	1,628	300
Expired arrangements	(995)	(196)	(1,701)	(377)
Payments	-	(103)	-	(113)
Interest	-	40	-	34
Closed accounts <sup>(1)</sup>	(605)	(76)	(125)	(22)
Advanced Forbearance Arrangements - Valuation Adjustments	-	(2)	-	-
Write-Offs <sup>(2)</sup>	(161)	(136)	-	-
Transfer from owner-occupier to buy-to-let	5	(1)	-	-
Other movements	-	-	(172)	(61)
<b>At 31 December</b>	<b>7,052</b>	<b>1,305</b>	<b>7,145</b>	<b>1,528</b>

**Total mortgage portfolio – subject to forbearance\***

	2015		2014	
	Number	Balance €m	Number	Balance €m
At 1 January	17,355	3,268	16,308	3,399
Additions	3,909	612	5,053	895
Expired arrangements	(2,745)	(491)	(3,606)	(718)
Payments	-	(195)	-	(212)
Interest	-	82	-	61
Closed accounts <sup>(1)</sup>	(907)	(108)	(190)	(31)
Advanced Forbearance Arrangements - Valuation Adjustments	-	(13)	-	-
Write-Offs <sup>(2)</sup>	(182)	(158)	-	-
Transfer from owner-occupier to buy-to-let	-	-	-	-
Other movements	-	-	(210)	(126)
<b>At 31 December</b>	<b>17,430</b>	<b>2,997</b>	<b>17,355</b>	<b>3,268</b>

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

<sup>(2)</sup> Includes contracted and non-contracted write-offs in 2015

The stock of loans subject to forbearance measures decreased by €271m in 2015 (2014: decrease of €131m) due to the expiry of short-term forbearance arrangements (e.g. periods of interest only or fixed repayments) which were not matched by new arrangements in the period.

\*Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

The following tables further 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 2015 and 31 December 2014:

## Residential owner-occupier mortgages\*

	2015					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	673	139	245	55	428	84
Reduced payment (greater than interest only)	541	128	293	81	248	47
Payment moratorium	245	42	59	11	186	31
Fundamental Restructures	-	-	-	-	-	-
Low fixed interest rate	218	44	35	7	183	37
Arrears capitalisation	4,818	825	2,493	459	2,325	366
Term extension	2,393	297	168	25	2,225	272
Split mortgage	740	131	228	33	512	98
Sale for loss	170	8	57	4	113	4
Positive equity solution	578	77	68	9	510	68
Other	2	1	-	-	2	1
<b>Total</b>	<b>10,378</b>	<b>1,692</b>	<b>3,646</b>	<b>684</b>	<b>6,732</b>	<b>1,008</b>

  

	2014					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	1,180	224	549	112	631	112
Reduced payment (greater than interest only)	1,074	218	708	160	366	58
Payment moratorium	260	49	72	15	188	34
Low fixed interest rate	49	11	10	3	39	8
Arrears capitalisation	4,409	812	2,954	606	1,455	206
Term extension	2,479	319	210	38	2,269	281
Split mortgage	531	88	455	68	76	20
Sale for loss	129	8	69	6	60	2
Positive equity solution	98	11	21	3	77	8
Other	1	-	-	-	1	-
<b>Total</b>	<b>10,210</b>	<b>1,740</b>	<b>5,048</b>	<b>1,011</b>	<b>5,162</b>	<b>729</b>

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Buy-to-let mortgages\*

	2015					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	1,126	235	434	87	692	148
Reduced payment (greater than interest only)	591	149	306	70	285	79
Payment moratorium	191	27	145	22	46	5
Fundamental Restructures	1,183	184	99	16	1,084	168
Low fixed interest rate	8	1	1	-	7	1
Arrears capitalisation	2,918	586	1,926	389	992	197
Term extension	828	111	117	17	711	94
Split mortgage	28	5	12	2	16	3
Sale for loss	161	5	33	2	128	3
Positive equity solution	18	2	3	-	15	2
Other	-	-	-	-	-	-
<b>Total</b>	<b>7,052</b>	<b>1,305</b>	<b>3,076</b>	<b>605</b>	<b>3,976</b>	<b>700</b>

	2014					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	1,708	371	933	216	775	155
Reduced payment (greater than interest only)	748	179	430	107	318	72
Payment moratorium	291	40	154	22	137	18
Low fixed interest rate	2	-	1	-	1	-
Arrears capitalisation	3,461	818	2,917	718	544	100
Term extension	765	105	170	28	595	77
Split mortgage	15	2	14	2	1	-
Sale for loss	150	12	109	10	41	2
Positive equity solution	5	1	3	-	2	1
Other	-	-	-	-	-	-
<b>Total</b>	<b>7,145</b>	<b>1,528</b>	<b>4,731</b>	<b>1,103</b>	<b>2,414</b>	<b>425</b>

\*Forms an integral part of the audited financial statements.



## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Total mortgage portfolio\*

	2015					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	1,799	374	679	142	1,120	232
Reduced payment (greater than interest only)	1,132	277	599	151	533	126
Payment moratorium	436	69	204	33	232	36
Fundamental Restructures	1,183	184	99	16	1,084	168
Low fixed interest rate	226	45	36	7	190	38
Arrears capitalisation	7,736	1,411	4,419	848	3,317	563
Term extension	3,221	408	285	42	2,936	366
Split mortgage	768	136	240	35	528	101
Sale for loss	331	13	90	6	241	7
Positive equity solution	596	79	71	9	525	70
Other	2	1	-	-	2	1
<b>Total</b>	<b>17,430</b>	<b>2,997</b>	<b>6,722</b>	<b>1,289</b>	<b>10,708</b>	<b>1,708</b>

	2014					
	Total		Loans >90 days in arrears and/or impaired		Loans neither >90 days in arrears nor impaired	
	Number	Balance € m	Number	Balance € m	Number	Balance € m
Interest only	2,888	595	1,482	328	1,406	267
Reduced payment (greater than interest only)	1,822	397	1,138	267	684	130
Payment moratorium	551	89	226	37	325	52
Low fixed interest rate	51	11	11	3	40	8
Arrears capitalisation	7,870	1,630	5,871	1,324	1,999	306
Term extension	3,244	424	380	66	2,864	358
Split mortgage	546	90	469	70	77	20
Sale for loss	279	20	178	16	101	4
Positive equity solution	103	12	24	3	79	9
Other	1	-	-	-	1	-
<b>Total</b>	<b>17,355</b>	<b>3,268</b>	<b>9,779</b>	<b>2,114</b>	<b>7,576</b>	<b>1,154</b>

A key feature of the forbearance portfolio is the growth in the proportion of advanced forbearance solutions (mainly split mortgages, positive equity solutions and low fixed interest rate) driven by the AIB Group's strategy to deliver sustainable long-term solutions to customers. Advanced forbearance solutions at €273 million accounted for 9% of the total forbearance portfolio as at 31 December 2015, compared to 4% (€133 million) as at 31 December 2014. Following restructure, loans are reported as impaired for a probationary period of at least 12 months (unless part of a larger individually assessed case).

47.1% of the loans subject to forbearance measures at 31 December 2015 are loans on which arrears have been capitalised. These loans, along with Term Extensions, remain within the stock of forbearance for a period of 5 years. The increase in the stock of loans on arrears capitalisation in 2015 includes some customers whose interest only arrangement had expired during 2015 but who received a capitalisation of arrears at some time over the last 5 years.

Interest income on impaired loans amounted to €106 million in 2015. At 31 December 2015, the net carrying value of impaired loans amounted to €1,945 million (€2,902m Impaired Balance - €957m Closing Provision) which included forborne impaired mortgages of €1,119 million. (€1,648m Forborne Impaired Balance - €529m Forborne Closing Provision).

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Credit profile of residential mortgages in forbearance

## Forbearance stock - past due but not impaired\*

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.

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 2015 and 31 December 2014:

	2015		
	Owner – Occupier € m	Buy-to-Let € m	Total € m
1 - 30 days	56	47	103
31 - 60 days	20	22	42
61 - 90 days	12	10	22
91 - 180 days	16	9	25
181 - 365 days	18	8	26
Over 365 days	36	17	53
<b>Total past due but not impaired</b>	<b>158</b>	<b>113</b>	<b>271</b>

  

	2014		
	Owner – Occupier € m	Buy-to-Let € m	Total € m
1 - 30 days	39	28	67
31 - 60 days	21	13	34
61 - 90 days	17	7	24
91 - 180 days	31	13	44
181 - 365 days	38	14	52
Over 365 days	32	17	49
<b>Total past due but not impaired</b>	<b>178</b>	<b>92</b>	<b>270</b>

9% of the residential mortgage portfolio that was subject to forbearance measures was past due but not impaired at 31 December 2015 (8%: 31 December 2014).

## Forbearance stock – impaired\*

The following table profiles the residential mortgage portfolio that was subject to forbearance measures and which was impaired at 31 December 2015 and 31 December 2014:

	2015		
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Not past due	253	181	434
1 - 30 days	51	25	76
31 - 60 days	20	12	32
61 - 90 days	12	11	23
91 - 180 days	30	26	56
181 - 365 days	34	46	80
Over 365 days	214	270	484
<b>Total impaired</b>	<b>614</b>	<b>571</b>	<b>1,185</b>

\*Forms an integral part of the audited financial statements

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Forbearance (continued)

## Credit profile of residential mortgages in forbearance (continued)

## Forbearance stock – impaired (continued)\*

			2014
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Not past due	301	288	589
1 - 30 days	59	44	103
31 - 60 days	27	26	53
61 - 90 days	20	25	45
91 - 180 days	61	68	129
181 - 365 days	105	144	249
Over 365 days	336	465	801
<b>Total impaired</b>	<b>909</b>	<b>1,060</b>	<b>1,969</b>

The proportion of forbearance that is impaired decreased from 60% at 31 December 2014 to 40% at 31 December 2015. This is mainly due to accounts restructured in 2014 becoming unimpaired after a probationary period of 12 months. The proportion of forbore impaired loans that were not past due increased from 30% at 31 December 2014 to 37% at 31 December 2015.

**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 2015 and 31 December 2014:

Loan-to-value (LTV) ratio			2015
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	403	170	573
50% - 70%	388	210	598
71% - 80%	182	111	293
81% - 90%	172	116	288
91% - 100%	148	131	279
101% - 120%	231	245	476
121% - 150%	137	187	324
Greater than 150%	23	130	153
Unsecured (Zero Collateral)	8	5	13
<b>Total forbearance</b>	<b>1,692</b>	<b>1,305</b>	<b>2,997</b>

Loan-to-value (LTV) ratio			2014
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	325	111	436
50% - 70%	330	141	471
71% - 80%	181	101	282
81% - 90%	171	126	297
91% - 100%	146	129	275
101% - 120%	269	300	569
121% - 150%	245	350	595
Greater than 150%	65	258	323
Unsecured (Zero Collateral)	8	12	20
<b>Total forbearance</b>	<b>1,740</b>	<b>1,528</b>	<b>3,268</b>

The degree of negative equity in the residential mortgage portfolio that was subject to forbearance measures at 31 December 2015 has reduced to 24% of the owner-occupier and 43% of the buy-to-let mortgages compared to 34% and 60% respectively at 31 December 2014, due primarily to the increase in property prices and loan repayments in 2015.

\* Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Properties in possession\*

AIB seeks to avoid repossession through working with customers, but where agreement cannot be reached, AIB proceeds to repossession of the property or the appointment of a fixed asset receiver, using external agents to realise the maximum value as soon as is practicable. Where AIB believes that the sale of a property will comprise only part of the recoverable amount of the loan against which it was being held as security, the customer remains liable for the outstanding balance and the remaining loan continues to be recognised on the statement of financial position.

For the purpose of the following table, a residential property is considered to be in AIB's possession when AIB has taken possession of and is in a position to dispose of the property. This includes situations of repossession, voluntary surrender and abandonment of the property.

The number (stock) of properties as at 31 December 2015 and 31 December 2014 is set out below:

	2015		2014	
	Stock	Balance Outstanding € m	Stock	Balance Outstanding € m
Owner-occupier	127	27	81	22
Buy-to-let	64	12	58	13
<b>Total</b>	<b>191</b>	<b>39</b>	<b>139</b>	<b>35</b>

The increase in the stock of repossessed properties in 2015 relates to 114 properties repossessed offset by 62 disposals. There continues to be an increase in stock due to the continued focus on arrears management.

The following tables analyse the disposals of repossessed properties during the years 31 December 2015 and 31 December 2014:

	2015					
	Number of Disposals	Balance outstanding at repossession date € m	Gross sales proceeds € m	Costs to sell € m	Loss on sale <sup>(1)</sup> € m	Average LTV at sale Price %
Owner-occupier	36	12	6	1	6	198%
Buy-to-let	26	6	2	-	4	251%
<b>Total residential</b>	<b>62</b>	<b>18</b>	<b>8</b>	<b>1</b>	<b>10</b>	<b>213%</b>

  

	2014					
	Number of Disposals	Balance outstanding at repossession date € m	Gross sales proceeds € m	Costs to sell € m	Loss on sale <sup>(1)</sup> € m	Average LTV at sale Price %
Owner-occupier	11	3	2	-	2	206%
Buy-to-let	19	6	2	-	4	247%
<b>Total residential</b>	<b>30</b>	<b>9</b>	<b>4</b>	<b>-</b>	<b>6</b>	<b>231%</b>

<sup>(1)</sup>Before specific impairment provisions.

The figures in the tables above do not cross total due to rounding.

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

The disposal of 62 residential properties resulted in a loss on disposal of €10m at 31 December 2015 (before specific impairment provisions). (2014: 30 disposals, €6m loss on disposal).

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

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

The property values used in the completion of the following loan-to-value tables are determined with reference to the original or most recent valuation, indexed to the Central Statistics Office ("CSO") Residential Property Price Index for November 2015. The CSO Residential Property Price Index for November 2015 reported that national residential property prices were 34% lower than their highest level in early 2007 and reported an annual rise in residential property prices of 6.5% in the year to 30 November 2015.

## Actual and average LTV across mortgage portfolios\*

The following tables profile the residential mortgage portfolio by the indexed loan-to-value ('LTV') ratios and the weighted average indexed LTV ratios at 31 December 2015 and 31 December 2014:

Loan-to-value (LTV) ratio			2015
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	4,084	884	4,968
50% - 70%	3,920	911	4,831
71% - 80%	2,194	464	2,658
81% - 90%	1,853	443	2,296
91% - 100%	1,248	451	1,699
101% -120%	1,632	689	2,321
121% - 150%	704	455	1,159
Greater than 150%	126	342	468
Unsecured (Zero Collateral)	26	54	80
<b>Total</b>	<b>15,787</b>	<b>4,693</b>	<b>20,480</b>
Weighted average indexed LTV <sup>(1)</sup>			
Stock of residential mortgages at year end	70%	87%	74%
New residential mortgages during year	71%	59%	70%
Impaired mortgages	92%	108%	101%

  

Loan-to-value (LTV) ratio			2014
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	3,505	717	4,222
50% - 70%	3,492	779	4,271
71% - 80%	1,874	465	2,339
81% - 90%	1,897	499	2,396
91% - 100%	1,382	492	1,874
101% -120%	2,120	967	3,087
121% - 150%	1,592	975	2,567
Greater than 150%	289	738	1,027
Unsecured (Zero Collateral)	22	66	88
<b>Total</b>	<b>16,173</b>	<b>5,698</b>	<b>21,871</b>
Weighted average indexed LTV <sup>(1)</sup>			
Stock of residential mortgages at year end	78%	102%	84%
New residential mortgages during year	69%	55%	69%
Impaired mortgages	101%	125%	115%

<sup>(1)</sup>Weighted average indexed LTV's are the individual indexed LTV calculations weighted by the mortgage balance against each property.

The weighted average indexed loan-to-value for the total residential mortgage book was 74% at 31 December 2015 compared to 84% at 31 December 2014, with the reduction driven primarily by the increase in property prices in 2014, coupled with amortisation of the loan book and restructuring activities.

\*Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Actual and average LTV across mortgage portfolios (continued)

## 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 2015 and 31 December 2014.

Loan-to-value (LTV) ratio	2015		2015
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	3,802	711	4,513
50% - 70%	3,628	690	4,318
71% - 80%	2,031	328	2,359
81% - 90%	1,687	284	1,971
91% - 100%	1,079	264	1,343
101% - 120%	1,349	335	1,684
121% - 150%	447	156	603
Greater than 150%	71	111	182
Unsecured (Zero Collateral)	9	10	19
<b>Total</b>	<b>14,103</b>	<b>2,889</b>	<b>16,992</b>

  

Loan-to-value (LTV) ratio	2014		2014
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	3,191	570	3,761
50% - 70%	3,144	560	3,704
71% - 80%	1,666	300	1,966
81% - 90%	1,664	293	1,957
91% - 100%	1,193	259	1,452
101% - 120%	1,698	406	2,104
121% - 150%	1,134	249	1,383
Greater than 150%	120	122	242
Unsecured (Zero Collateral)	4	4	8
<b>Total</b>	<b>13,814</b>	<b>2,763</b>	<b>16,577</b>

## Past due but not impaired\*

The following tables profile the residential mortgage portfolio that was past due but not impaired at 31 December 2015 and 31 December 2014.

Loan-to-value (LTV) ratio	2015		2015
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	115	44	159
50% - 70%	100	47	147
71% - 80%	36	18	54
81% - 90%	37	22	59
91% - 100%	25	23	48
101% - 120%	29	29	58
121% - 150%	20	16	36
Greater than 150%	3	19	22
Unsecured (Zero Collateral)	1	2	3
<b>Total</b>	<b>366</b>	<b>220</b>	<b>586</b>

  

Loan-to-value (LTV) ratio	2014		2014
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	138	41	179
50% - 70%	107	38	145
71% - 80%	51	23	74
81% - 90%	41	23	64
91% - 100%	32	23	55
101% - 120%	60	38	98
121% - 150%	37	35	72
Greater than 150%	7	22	29
Unsecured (Zero Collateral)	-	-	-
<b>Total</b>	<b>473</b>	<b>243</b>	<b>716</b>

\*Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Actual and average LTV across mortgage portfolios (continued)

## Past due but not impaired (continued)

Of the residential mortgages that were past due but not impaired at 31 December 2015, 14% of owner-occupier and 30% of buy-to-let mortgages were in negative equity (31 December 2014: 22% and 39% respectively). In terms of the total portfolio that was past due but not impaired, 20% was in negative equity at 31 December 2015 (31 December 2014: 28%).

## 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 2015 and 31 December 2014.

Loan-to-value (LTV) ratio	2015		2015
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	221	149	370
50% - 70%	237	193	430
71% - 80%	143	124	267
81% - 90%	144	143	287
91% - 100%	149	172	321
101% -120%	260	337	597
121% - 150%	244	294	538
Greater than 150%	52	222	274
Unsecured (Zero Collateral)	17	42	59
<b>Total</b>	<b>1,467</b>	<b>1,676</b>	<b>3,143</b>

  

Loan-to-value (LTV) ratio	2014		2014
	Owner – Occupier € m	Buy-to-Let € m	Total € m
Less than 50%	250	127	377
50% - 70%	294	197	491
71% - 80%	181	152	333
81% - 90%	204	193	397
91% - 100%	167	218	385
101% -120%	377	537	914
121% - 150%	430	710	1,140
Greater than 150%	165	607	772
Unsecured (Zero Collateral)	17	62	79
<b>Total</b>	<b>2,085</b>	<b>2,803</b>	<b>4,888</b>

Of the residential mortgages that were greater than 90 days past due and/or impaired at 31 December 2015, the proportion in negative equity (47%) decreased in comparison to 31 December 2014 (59%), reflecting the increases in residential property prices in the period.

## Residential Mortgages by year of origination\*

The following tables profile the residential mortgage portfolio and impaired residential mortgage portfolio at 31 December 2015 and 2014 by year of origination.

	Mortgage portfolio		Impaired mortgage portfolio		2015
	Number	Balance € m	Number	Balance € m	
1996 and before	1,308	18	189	4	
1997	905	14	82	2	
1998	1,271	32	152	6	
1999	1,724	65	193	12	
2000	2,386	108	267	18	
2001	3,000	150	262	19	
2002	5,087	350	494	47	
2003	7,933	702	889	103	
2004	10,912	1,190	1,442	209	
2005	14,535	1,901	2,261	382	
2006	19,232	3,068	3,503	710	
2007	18,147	3,058	3,026	656	
2008	17,225	2,912	2,222	495	
2009	11,706	1,852	909	180	
2010	7,298	1,109	224	46	
2011	3,411	503	57	10	
2012	6,111	918	17	2	
2013	4,783	739	3	1	
2014	4,896	740	1	-	
2015	6,750	1,051	1	-	
<b>Total</b>	<b>148,620</b>	<b>20,480</b>	<b>16,194</b>	<b>2,902</b>	

\*Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.1 Credit risk (continued)

## Residential Mortgages by year of origination (continued)\*

	Mortgage portfolio		Impaired mortgage portfolio	
	Number	Balance € m	Number	Balance € m
1996 and before	2,011	27	251	6
1997	1,003	19	118	3
1998	1,405	42	213	9
1999	1,933	79	258	17
2000	2,904	132	374	27
2001	3,249	181	365	28
2002	5,500	413	706	75
2003	8,587	817	1,261	169
2004	11,637	1,372	1,982	328
2005	15,748	2,179	3,112	609
2006	20,254	3,498	4,682	1,089
2007	18,973	3,479	4,105	1,048
2008	17,993	3,278	3,070	800
2009	12,344	2,045	1,270	284
2010	7,698	1,217	306	69
2011	3,569	549	74	13
2012	6,368	1,002	20	3
2013	4,939	792	4	1
2014	4,984	750	-	-
<b>Total</b>	<b>151,099</b>	<b>21,871</b>	<b>22,171</b>	<b>4,578</b>

The majority (€12.8bn or 62%) of the €20.5bn residential mortgage portfolio was originated between 2005 and 2009, of which, 19.0% (€2.4bn) was impaired at 31 December 2015.

## Further information on credit risk

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

- Provisions for impairment of loans and receivables (note 8);
- Derivative financial instruments (note 10);
- Loans and receivables to banks (note 11); and
- Loans and receivables to customers (note 12).

\*Forms an integral part of the audited financial statements.



**RISK MANAGEMENT REPORT (CONTINUED)****3.2 Liquidity risk\***

Liquidity risk is the risk that the Bank will not be able to fund its assets and meet its payment obligations as they come due, without incurring unacceptable costs or losses. 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. It also sets out the outsourcing arrangements which have been established with AIB 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 Single Supervisory Mechanism ("SSM").

The MBPN 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 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 any short term borrowings under the MBPN Facility and to lend to mortgage customers in accordance with outstanding offer letters. It is the Bank's policy to ensure that resources are available at all times to meet its obligations.

AIB monitors and manages the funding support provided by its deposit base to its loan portfolio through a series of measures including the CRD IV related liquidity ratios i.e. the Liquidity Coverage Ratio ("LCR") and Net Stable Funding Ratio ("NSFR") as required by the 2013 Capital Requirements Regulation ("CRR") and the Capital Requirements Directive ("CRD") and ultimately the LCR as required by the published European Commission Delegated Regulation ("the Delegated Act") to supplement the CRR and which came into force on 1 October 2015.

The SSM requires credit institutions to comply with a cash flow maturity mismatch approach for the management of their liquidity. This involves credit institutions analysing their cash flows on a consolidated basis under various headings and placing them in pre-determined time bands depending on when the cash is received or paid out.

On a day-to-day basis, the Bank meets its residual funding requirements through borrowing facilities in place with AIB and with the Central Bank of Ireland. The table on page 33 analyses the liabilities into relevant maturity groupings based on the remaining period at the reporting date to contractual maturity date.

In accordance with the Capital Requirements Regulation, the Bank has appointed AIB as its liquidity manager to fulfil daily cash flow management, oversee any changes required in liquidity management or reporting and manage the Bank's liquidity risk as part of the overall AIB liquidity risk management process. The means by which these liquidity management activities are performed, and the procedures by which AIB ensures the Bank complies with the AIB Group Liquidity Policy are managed through an Outsourcing and Agency Agreement.

\*Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.2 Liquidity risk (continued)

## Financial liabilities by contractual maturity\*

						2015
	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	10,650	1,000	-	-	-	11,650
Customer accounts	1	-	-	-	-	1
Derivative financial instruments	-	-	-	-	1	1
Debt securities in issue	-	-	500	3,490	1,925	5,915
Subordinated liabilities	-	-	-	-	300	300
Other liabilities	4	14	57	156	24	255
<b>Total</b>	<b>10,655</b>	<b>1,014</b>	<b>557</b>	<b>3,646</b>	<b>2,250</b>	<b>18,122</b>
Off-balance sheet Commitments	394	-	-	-	-	394

  

						2014
	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	12,966	1,000	-	-	-	13,966
Customer accounts	1	-	-	-	-	1
Derivative financial instruments	-	-	-	-	1	1
Debt securities in issue	-	-	500	2,740	1,675	4,915
Subordinated liabilities	-	-	-	-	300	300
Other liabilities	2	-	66	233	34	335
<b>Total</b>	<b>12,969</b>	<b>1,000</b>	<b>566</b>	<b>2,973</b>	<b>2,010</b>	<b>19,518</b>
Off-balance sheet Commitments	349	-	-	-	-	349

## 3.3 Conduct risk\*

Conduct Risk is the risk that inappropriate actions, or inaction, by AIB Group can cause poor and unfair outcomes for its customers, and potential market instability. The Group Conduct Risk management strategy is to adopt sound practices in the identification, evaluation, mitigation, monitoring and reporting of Conduct Risks to ensure that they are managed in accordance with Conduct Risk Appetite of AIB Group. This includes the embedding of a customer centric culture aligned to AIB's Brand Values and Code of Conduct, the promotion of good conduct throughout the organisation and the operation of a control environment for the measurement and management of Conduct Risk, in accordance with the relevant limits and other requirements set out in the Board Risk Appetite Statement.

The Central Bank announced in October 2015 that it had commenced a broad examination of tracker mortgage-related issues across Irish Banks. In December 2015, the Central Bank confirmed to the affected banks that the objective of the Examination is to assess compliance with both contractual and regulatory requirements. In circumstances where customer detriment is identified from this Examination, the Group is required to provide appropriate redress and compensation in line with the CBI "Principles for Redress". Notwithstanding the provisions for customer redress as set out in note 22 "Provisions for liabilities and commitments", it is not possible at this stage to assess the final outcome of the Examination or any related litigation or regulatory action required.

## 3.4 Operational risk\*

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk, information technology risk, business continuity risk, outsourcing risk, health and safety risk and legal risk. It does not include strategic and business risk. As such, operational risk covers a broad range of potential sources of financial loss which the Bank and AIB Group actively seek to mitigate against.

The key people, systems and processes supporting the Bank are provided by the Group and this relationship is governed by an outsourcing and agency agreement. AIB Groups operational risk framework applies across all areas of the Group including AIB Mortgage Bank and the Group Operational Risk function is responsible for overseeing the management of operational risk across AIB Group. A key focus of operational risk management in AIB Mortgage Bank is the oversight of outsourced service activities, in particular activities related to the requirements of the ACS Act, as well as the end-to-end mortgage origination and servicing processes.

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

\*Forms an integral part of the audited financial statements.

**RISK MANAGEMENT REPORT (CONTINUED)****3.5 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.

The level of regulatory risk remained high in 2015 as the regulatory landscape for the banking sector continued to evolve with a strong focus on supporting the stability of the banking system and ensuring appropriate resolution and recovery mechanisms are in place post the global financial crisis. The Bank is committed to proactively identifying regulatory and compliance obligations arising in the Bank's operating markets in Ireland, and ensuring the timely implementation of regulatory change. Throughout 2015, projects were mobilised within AIB Group to prepare for the significant regulatory change horizon as outlined in AIB Group's annual report: Governance and Oversight – Supervision and Regulation.

The level of regulatory change is expected to continue in 2016.

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.

**3.6 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 tracker interest rate mortgage loans, where the interest rate 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 Allied Irish Bank, p.l.c. 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.

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. AIB and the Bank amended the Pool and the Non-Pool Hedge structure in December 2013 to include a one-sided free option for the AIB Mortgage Bank to terminate the swaps without cost on any reset date.

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

The total nominal values of the swaps are set out in note 10 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.

\*Forms an integral part of the audited financial statements.

## RISK MANAGEMENT REPORT (CONTINUED)

## 3.6 Non-trading interest rate risk\* (continued)

## Interest Rate Sensitivity\*

The net interest rate sensitivity of AIB Mortgage Bank at 31 December 2015 is illustrated in the following table:

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	18,397	201	738	331	387	78	291	57	(1,109)	19,371
Loans and receivables to bank	409	-	-	-	-	-	-	-	-	409
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	249	249
Other assets	-	-	-	-	-	-	-	-	133	133
<b>Total Assets</b>	<b>18,806</b>	<b>201</b>	<b>738</b>	<b>331</b>	<b>387</b>	<b>78</b>	<b>291</b>	<b>57</b>	<b>(727)</b>	<b>20,162</b>
<b>Liabilities</b>										
Deposits by banks	11,650	-	-	-	-	-	-	-	-	11,650
Customer accounts	1	-	-	-	-	-	-	-	-	1
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	1	1
Debt issued	1,150	-	500	1,675	500	65	750	1,275	-	5,915
Subordinated liabilities	300	-	-	-	-	-	-	-	-	300
Other liabilities	-	-	-	-	-	-	-	-	353	353
Shareholders' equity	-	-	-	-	-	-	-	-	1,942	1,942
<b>Total Liabilities</b>	<b>13,101</b>	<b>-</b>	<b>500</b>	<b>1,675</b>	<b>500</b>	<b>65</b>	<b>750</b>	<b>1,275</b>	<b>2,296</b>	<b>20,162</b>
<b>Derivatives financial instruments (interest rate swaps)</b>										
Floating rate interest receivable	(21,074)	-	-	-	-	-	-	-	-	(21,074)
Floating rate interest payable	18,991	201	738	331	387	78	291	57	-	21,074
Fixed rate interest payable	4,765	-	(500)	(1,675)	(500)	(65)	(750)	(1,275)	-	4,765
Fixed rate interest receivable	-	-	238	(1,344)	(113)	13	(459)	(1,218)	-	(4,765)
<b>Total derivatives</b>	<b>2,682</b>	<b>201</b>	<b>238</b>	<b>(1,344)</b>	<b>(113)</b>	<b>13</b>	<b>(459)</b>	<b>(1,218)</b>	<b>-</b>	<b>0</b>
<b>Interest sensitivity gap</b>	<b>3,023</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>(3,023)</b>	<b>-</b>
<b>Cumulative interest sensitivity gap</b>	<b>3,023</b>	<b>3,023</b>	<b>3,023</b>	<b>3,023</b>	<b>3,023</b>	<b>3,023</b>	<b>3,023</b>	<b>3,023</b>	<b>-</b>	<b>-</b>

The impact on net interest income over a twelve month period of a 100 basis point ("bp") downward/upward movement in interest rates on 31 December 2015 would be circa -€71k/€232k respectively.

\*Forms an integral part of the audited financial statements.

**AIB MORTGAGE BANK**

**RISK MANAGEMENT REPORT (CONTINUED)**

**3.6 Non-trading interest rate risk\* (continued)**

**Interest Rate Sensitivity\* (continued)**

Interest Rate Sensitivity analysis for the Bank at 31 December 2014 is as follows:

	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
<b>Assets</b>										
Loans and receivables to customers	20,246	158	722	382	141	39	67	116	(1,951)	19,920
Loans and receivables to bank	469	-	-	-	-	-	-	-	329	469
Derivatives and other financial instruments	-	-	-	-	-	-	-	-	204	204
Other assets	20,715	158	722	382	141	39	67	116	(1,418)	20,922
<b>Total Assets</b>										
	13,966	-	-	-	-	-	-	-	-	13,966
<b>Liabilities</b>										
Deposits by banks	1	-	-	-	-	-	-	-	1	1
Customer accounts	-	-	-	-	-	-	-	-	-	-
Derivatives and other financial instruments	1,150	-	500	500	1,675	500	65	525	-	4,915
Debt issued	300	-	-	-	-	-	-	-	335	335
Subordinated liabilities	-	-	-	-	-	-	-	-	1,404	1,404
Other liabilities	-	-	-	-	-	-	-	-	1,740	1,740
Shareholders' equity	15,417	-	500	500	1,675	500	65	525	-	20,922
<b>Total Liabilities</b>										
	(22,258)	158	722	382	141	39	67	116	-	(22,258)
<b>Derivatives financial instruments (interest rate swaps)</b>										
Floating rate interest receivable	20,633	-	-	-	-	-	-	-	-	20,633
Floating rate interest payable	3,765	-	(500)	(500)	(1,675)	(500)	(65)	(525)	-	3,765
Fixed rate interest receivable	-	158	222	(118)	(1,534)	(461)	2	(409)	-	(3,765)
<b>Total derivatives</b>	2,140	158	222	(118)	(1,534)	(461)	2	(409)	-	-
<b>Interest sensitivity gap</b>	3,158	3,158	3,158	3,158	3,158	3,158	3,158	3,158	-	-
<b>Cumulative interest sensitivity gap</b>	3,158	3,158	3,158	3,158	3,158	3,158	3,158	3,158	-	-

The impact on net interest income over a twelve month period of a 100 basis point ("bp") downward/ upward movement in interest rates on 31 December 2014 would be circa €205k/ €36k respectively.

\*Forms an integral part of the audited financial statements.

**DIRECTORS' RESPONSIBILITY STATEMENT**

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

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

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

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

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

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

On behalf of the Board



Dave Keenan  
Chairman

  
Jim O'Keeffe  
Managing Director

Date: 15 March 2016

**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF  
AIB MORTGAGE BANK**

We have audited the financial statements of AIB Mortgage Bank (the "Bank") for the financial year ended 31 December 2015 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 Shareholders' Equity and the related notes. The relevant financial reporting framework that has been applied in their preparation is the Companies Act 2014 and International Financial Reporting Standards (IFRS) as adopted by the European Union ("relevant financial reporting framework").

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

**Respective responsibilities of directors and auditors**

As explained more fully in the Directors' Responsibility Statement, the directors are responsible for the preparation of the financial statements and for being satisfied that they give a true and fair view and otherwise comply with the Companies Act 2014. Our responsibility is to audit and express an opinion on the financial statements in accordance with the Companies Act 2014 and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

**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 Bank'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 financial statements to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

**Opinion on financial statements**

In our opinion, the financial statements:

- give a true and fair view of the assets, liabilities and financial position of the Bank as at 31 December 2015 and of the profit for the financial year then ended; and
- have been properly prepared in accordance with the relevant financial reporting framework and, in particular, with the requirements of the Companies Act 2014.

*Continued on next page/*



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**INDEPENDENT AUDITORS' REPORT TO THE MEMBERS OF  
AIB MORTGAGE BANK**

**Matters on which we are required to report by the Companies Act 2014**

- We have obtained all the information and explanations which we consider necessary for the purposes of our audit.
- In our opinion the accounting records of the Bank were sufficient to permit the financial statements to be readily and properly audited.
- The financial statements are in agreement with the accounting records.
- In our opinion the information given in the directors' report is consistent with the financial statements.

**Matters on which we are required to report by exception**

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



John McCarroll  
For and on behalf of Deloitte  
Chartered Accountants and Statutory Audit Firm  
Hardwicke House  
Hatch Street  
Dublin 2

15 March 2016



## INCOME STATEMENT

For the financial year ended 31 December 2015

	Note	2015 €m	2014 €m
Interest income and similar income	3	663	669
Interest expense and similar charges	4	(212)	(293)
<b>Net Interest Income</b>		<b>451</b>	<b>376</b>
Net trading gain	5	-	1
Other operating income	6	2	-
<b>Total Operating Income</b>		<b>453</b>	<b>377</b>
Administrative expenses	7	(161)	(61)
<b>Operating profit before impairment losses and taxation</b>		<b>292</b>	<b>316</b>
Writeback for impairment of loans and receivables to customers	8	323	100
<b>Operating profit before taxation</b>		<b>615</b>	<b>416</b>
Income tax (charge)	9	(77)	(52)
<b>Profit for the year</b>		<b>538</b>	<b>364</b>

The operating profit arises from continuing operations.

The notes on pages 45 to 76 are an integral part of these financial statements.

## STATEMENT OF COMPREHENSIVE INCOME

For the financial year ended 31 December 2015

	2015	2014
	€m	€m
Profit for the year	538	364
Total comprehensive income for the year	538	364

## STATEMENT OF FINANCIAL POSITION

As at 31 December 2015

	Note	2015 € m	2014 € m
<b>Assets</b>			
Derivative financial instruments	10	249	329
Loans and receivables to banks	11	409	469
Loans and receivables to customers	12	19,371	19,920
Other assets	13	53	49
Deferred taxation	14	78	155
Assets held for Sale	15	2	-
<b>Total assets</b>		<b>20,162</b>	<b>20,922</b>
<b>Liabilities</b>			
Deposits by banks	16	11,650	13,966
Customer accounts	17	1	1
Derivative financial instruments	10	1	1
Debt securities in issue	18	5,915	4,915
Accruals and deferred income	19	69	66
Subordinated liabilities	20	300	300
Other liabilities	21	186	269
Provisions for liabilities and commitments	22	98	-
<b>Total liabilities</b>		<b>18,220</b>	<b>19,518</b>
<b>Shareholders' equity</b>			
Issued share capital presented as equity	23	1,745	1,745
Capital reserves	24	580	580
Revenue reserves		(383)	(921)
Shareholders' equity		1,942	1,404
<b>Total liabilities and shareholders' equity</b>		<b>20,162</b>	<b>20,922</b>

The notes on pages 45 to 76 are an integral part of these financial statements



Dave Keenan  
Chairman



Jim O'Keefe  
Managing Director



Gerry Gaffney  
Executive Director



Louise Cleary  
Secretary

Date: 15 March 2016

## STATEMENT OF CASH FLOWS

For the Financial year ended 31 December 2015

	Note	2015 € m	2014 € m
<b>Cash flows from operating activities</b>			
Operating profit/(loss) for the year before taxation		615	416
Change in accruals and deferred income	19	3	9
Change in provisions		98	-
(Writeback)/provisions for impairment on loans and receivables	8	(323)	(100)
		393	325
<b>Changes in operating assets and liabilities</b>			
Change in debt securities in issue		1,000	1,650
Change in derivative financial instruments		80	(21)
Change in deposits by banks		(2,316)	(2,917)
Change in other assets		(4)	(15)
Change in assets held for sale		(2)	-
Change in other liabilities		(83)	12
Change in loans and receivables to customers		872	972
<b>Net cash flows from operations before taxation</b>		<b>(60)</b>	<b>6</b>
Taxation paid		-	-
<b>Net cash flows from operations</b>		<b>(60)</b>	<b>6</b>
<b>Net cash flow from investing activities</b>		<b>-</b>	<b>-</b>
<b>Cash flows from financing activities</b>			
Proceeds from issue of ordinary share capital		-	-
<b>Net cash flows from financing activities</b>		<b>-</b>	<b>-</b>
<b>Net increase/(decrease) in cash and cash equivalents</b>		<b>(60)</b>	<b>6</b>
Cash and cash equivalents at 1 January		469	463
<b>Cash and cash equivalents at 31 December *</b>	<b>26</b>	<b>409</b>	<b>469</b>

\*Cash and cash equivalent balances include funds held as collateral for derivatives with AIB Group of €374m in 2015 (2014: €434m) and Cash Substitution Pool Assets with Barclays Bank p.l.c. of €35m in 2015 (2014: €35m). (Note 11)

The notes on pages 45 to 76 are an integral part of these financial statements.

## STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY

For the Financial year ended 31 December 2015

	Ordinary Share Capital € m	Capital Reserves € m	Revenue Reserves € m	Total Shareholders' Equity € m
At 1 January 2015	1,745	580	(921)	1,404
Total comprehensive income for the period	-	-	538	538
At 31 December 2015	1,745	580	(383)	1,942
At 1 January 2014	1,745	580	(1,285)	1,040
Total comprehensive income for the period	-	-	364	364
At 31 December 2014	1,745	580	(921)	1,404

## NOTES TO THE FINANCIAL STATEMENTS

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## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES

The accounting policies applied in the preparation of the financial statements for the financial year ended 31 December 2015 are set out below.

**1.1. 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 SSM. 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.

**1.2. Statement of compliance**

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

**1.3. Basis of preparation****Functional and presentation currency**

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

**Basis of measurement**

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

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

**Use of estimates and judgements**

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of certain assets, liabilities, revenues, expenses and disclosures of contingent assets and liabilities. The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Since management's judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. The estimates and underlying assumptions are reviewed on an on-going basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future periods affected. The estimates that have significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of loan impairment and impairment of other financial instruments; the recoverability of deferred tax and determination of the fair value of certain financial assets and liabilities, and provisions for liabilities and commitments. In addition, the designation of financial assets and financial liabilities has a significant impact on their income statement treatment and could have a significant impact on reported income. A description of these estimates and judgements is set out in note 2 of the financial statements.

**Going concern**

The financial statements for the financial year ended 31 December 2015 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment. The period of assessment used by the Directors is twelve months from the date of approval of these annual financial statements.

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 for the financial year ended 31 December 2015 have been prepared on a going concern basis as the Directors of 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 period of assessment. The period of assessment used by the Directors of AIB Group is twelve months from the date of approval of its annual financial statements.

In making its assessment, the Directors of AIB Group have considered a wide range of information relating to present and future conditions. These have included financial plans approved by the Board of AIB Group in December 2015 covering the period 2016 to 2018, the Restructuring Plan approved by the European Commission in May 2014, liquidity and funding forecasts, and capital resources projections, all of which have been prepared under base and stress scenarios. In formulating these plans, the current Irish economic environment and forecasts for growth and employment were considered as well as the stabilisation of property prices. The Directors of AIB Group have considered the outlook for the Irish, the eurozone and UK economies and the factors and uncertainties impacting their performance



## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.3. Basis of preparation (continued)

**Going concern (continued)**

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

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

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

On the basis of the above, the Directors of AIB Group 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 Groups ability to continue as a going concern over the period of assessment

**Conclusion**

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

**Adoption of new accounting standards**

During the year to 31 December 2015, the Group adopted amendments to standards and interpretations which had an insignificant impact on these financial statements.

## 1.4. Interest income and expense recognition

Interest income and expense is recognised in the income statement for all 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 financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument to the net carrying amount of the financial asset or financial liability. The application of the method has the effect of recognising income receivable and expense payable on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment.

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

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

Interest income and expense presented in the income statement includes:

- Interest on financial assets and financial liabilities at amortised cost on an effective interest method; and
- Net interest income and expense on qualifying hedge derivatives designated as cash flow hedges or fair value hedges which are recognised in interest income or interest expense.

## 1.5. Net trading income

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

## 1.6. Financial assets

**Loans and receivables**

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market and which are not classified as available for sale. They arise when the Bank provides money or services directly to a customer with no intention of trading the loan. Loans and receivables are initially recognised at fair value adjusted for direct and incremental transaction costs and are subsequently carried on an amortised cost basis.

## 1.7. Financial liabilities

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

Financial liabilities are initially recognised at fair value, being the issue proceeds (fair value of consideration received) net of transaction costs incurred. Financial liabilities are subsequently measured at amortised cost with any difference between the proceeds net of transaction costs and the redemption value is recognised in the Income Statement using the effective interest rate method.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.7. Financial liabilities (continued)

The Bank derecognises a financial liability when its contractual obligation is discharged, cancelled or expired. Any gain or loss on the extinguishment or re-measurement of a financial liability is recognised in profit or loss.

## 1.8. Derivatives and hedge accounting

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

**Derivatives**

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

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

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

**Hedging**

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

The Bank discontinues hedge accounting when:

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

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

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

**Fair value hedge accounting**

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

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

**Derivatives that do not qualify for hedge accounting**

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

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

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.9. Impairment of financial assets

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

**Impairment**

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

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

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

**Incurred but not reported**

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

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

**Collective evaluation of impairment**

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

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

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

**Impairment loss**

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

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

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

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.9. Impairment of financial assets (continued)

**Collateralised financial assets – Repossessions**

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

**Past due loans**

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

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

**Loans renegotiated and forbearance**

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

**Forbearance**

A forbearance agreement is entered into where the customer is in financial difficulty to the extent that they are unable to repay both the principal and interest on their loan in accordance with their original contract. Following an assessment of the customer's repayment capacity, a potential solution will be determined from the options available. There are a number of different types of forbearance options including interest and/or arrears capitalisation, interest rate adjustments, payment holidays, term extensions and split loans. These are detailed in the Credit Risk section 3.1. A request for a forbearance solution acts as a trigger for an impairment test.

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

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

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

**Non-forbearance renegotiation**

Occasionally, the Bank may temporarily amend the contractual repayments terms on a loan (e.g. payment moratorium) for a short period of time due to a temporary change in the life circumstances of the borrower. Because such events are not directly linked to repayment capacity, these amendments are not considered forbearance. The changes in expected cash flows are accounted for under IAS 39 paragraph 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.

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

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

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

**1.10. Non-credit risk provisions**

Provisions are recognised for present legal or constructive obligations arising as consequences of past events where it is probable that a transfer of economic benefit will be necessary to settle the obligation, and it can be reliably estimated.

When the effect is material, provisions are determined by discounting expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability. Payments are deducted from the present value of the provision, and interest at the relevant discount rate is charged annually to interest expense using the effective interest method. Changes in the present value of the liability as a result of movements in interest rates are included in other income. The present value of provisions is included in other liabilities.

**1.11. Income tax, including deferred tax**

Income tax comprises current and deferred tax. Income tax is recognised in the Income Statement except to the extent that it relates to items recognised in other comprehensive income, in which case it is recognised in other comprehensive income. Income tax relating to items in equity is recognised directly in equity.

Current tax is the expected tax payable on the taxable income for the financial year using tax rates enacted or substantively enacted at the reporting date and any adjustment to tax payable in respect of previous financial years.

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

The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred and current tax assets and liabilities are only offset when they arise in the same tax reporting group and where there is both the legal right and the intention to settle the current tax assets and liabilities on a net basis or to realise the asset and settle the liability simultaneously.

The principal temporary differences arise from the revaluation of certain financial assets and financial liabilities including derivative contracts.

**1.12. Cash and cash equivalents**

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

**1.13. Shareholder's Equity**

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

*Share capital*

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

*Dividends and distributions*

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders, or in the case of the interim dividend when it has been approved for payment by the Board of Directors.

*Capital reserves*

Capital reserves represent cash contribution from AIB p.l.c.

*Revenue reserves*

Revenue reserves represent retained earnings of the Bank.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.14 Determination of fair value of financial instruments

The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Group has access at that date. The Group considers the impact of non-performance risk when valuing its financial liabilities.

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

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

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

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

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

**Valuation techniques**

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

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

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

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

**NOTES TO THE FINANCIAL STATEMENTS (continued)****1. ACCOUNTING POLICIES (continued)****1.14 Determination of fair value of financial instruments (continued)****Valuation techniques (continued)**

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

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

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

**Transfers between levels of the fair value hierarchy**

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

**1.15 Non-current assets held for sale****Non-current assets held for sale**

A non-current asset is classified as held for sale if it is expected that its carrying amount will be recovered principally through sale rather than through continuing use, it is available for immediate sale and sale is highly probable within one year. For the sale to be highly probable, the appropriate level of management must be committed to a plan to sell the asset.

On initial classification as held for sale, generally, non-current assets are measured at the lower of previous carrying amount and fair value less costs to sell with any adjustments taken to the income statement. The same applies to gains and losses on subsequent re-measurement. Financial assets within the scope of IAS 39 continue to be measured in accordance with that standard.

Impairment losses subsequent to classification of assets as held for sale are recognised in the income statement. Subsequent increases in fair value less costs to sell 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 classified as held for sale are not depreciated.

Gains and losses on re-measurement and impairment losses subsequent to classification as non-current assets held for sale are shown within continuing operations in the income statement

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

**1.16 Foreign currency translation**

Items included in the financial statements of each of the Group's entities are measured using their functional currency, being the currency of the primary economic environment in which the entity operates.

**Transactions and balances**

Foreign currency transactions are translated into the respective entity's functional currency using the exchange rates prevailing at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies are re-translated at the rate prevailing at the period end. Foreign exchange gains and losses resulting from the settlement of such transactions and from the re-translation at period end exchange rates of the amortised cost of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.17. Prospective accounting changes

The following new accounting standards and amendments to existing standards approved by the IASB, but not early adopted by the Bank, will impact the Bank's financial reporting in future periods. The Bank is currently considering the impacts of these amendments. The new accounting standards and amendments which are more relevant to the Bank are detailed below;

**(a) Amendments to IAS 1 Presentation of Financial Statements: Disclosure Initiative**Nature of Change

The amendments to IAS 1 are designed to further encourage companies to apply professional judgement in determining what information to disclose in the financial statements. Furthermore, the amendments clarify that companies should use professional judgement in determining where and in what order information is presented in the financial disclosures.

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

IASB Effective Date

Annual periods beginning on or after 1 January 2016.

**(b) Annual improvements to IFRSs 2012–2014 cycle**Nature of Change

The IASB's annual improvements project provides a process for making amendments to IFRSs that are considered non-urgent but necessary. The amendments clarify guidance and wording, or correction for relatively minor unintended consequences, conflicts or oversights in existing IFRSs. Annual improvements to IFRSs 2012-2014 Cycle amend IFRSs in relation to four issues addressed during this cycle.

None of the amendments are expected to have a significant impact on reported results or disclosures.

IASB Effective Date

Annual periods beginning on or after 1 January 2016.

**(c) IFRS 15 Revenue from Contracts with Customers**Nature of Change

IFRS 15, which was issued in May 2014, replaces IAS 11 *Construction Contracts* and IAS 18 *Revenue* in addition to IFRIC 13, IFRIC 15, IFRIC 18 and SIC-31. IFRS 15 specifies how and when an entity recognises revenue from a contract with a customer through the application of a single, principles based five-step model. The standard specifies new qualitative and quantitative disclosure requirements to enable users of financial statements understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The impacts of this standard are being considered by the Bank. This standard is subject to EU endorsement.

IASB Effective Date

Annual periods beginning on or after 1 January 2018.

**(d) IFRS 9 Financial Instruments**Nature of Change

IFRS 9 Financial Instruments was issued in July 2014 and will replace IAS 39 Financial Instruments: Recognition and Measurement. IFRS 9 includes a revised classification and measurement model, a forward looking 'expected credit loss' impairment methodology and modifies the approach to hedge accounting. Unless early adopted, the standard is effective for accounting periods beginning 1 January 2018. The key changes under the standard are:

Classification and measurement

Financial assets are classified on the basis of the business model within which they are held and their contractual cashflow characteristics. The classification and measurement categories are amortised cost, fair value through other comprehensive income and fair value through profit and loss.

A financial asset is measured at amortised cost if two criteria are met: a) the objective of the business model is to hold the financial asset for the collection of the contractual cash flows, and b) the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest.

If a financial asset is eligible for amortised cost measurement, an entity can elect to measure it at fair value if it eliminates or significantly reduces an accounting mismatch.

Interest is calculated on the gross carrying amount of a financial assets, except where the asset is credit impaired in which case interest is calculated on the carrying amount after deducting the impairment provision.

There is no separation of an embedded derivative where the instrument is a financial asset.



## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.17. Prospective accounting changes (continued)

## (d) IFRS 9 Financial Instruments (continued)

Classification and measurement (continued)

Equity instruments must be measured at fair value, however, an entity can elect on initial recognition to present fair value changes, including any related foreign exchange component on non-trading equity investments directly in other comprehensive income. There is no subsequent recycling of fair value gains and losses to profit or loss; however dividends from such investments will continue to be recognised in profit or loss.

Impairment

Requires more timely recognition of expected credit losses using a three stage approach. For financial assets where there has been no significant increase in credit risk since origination, a provision for 12 months expected credit losses is required. For financial assets where there has been a significant increase in credit risk or where the asset is credit impaired, a provision for full lifetime expected losses is required.

The assessment of whether credit risk has increased significantly since origination is performed for each reporting period by considering the change in risk of default occurring over the remaining life of the financial instrument, rather than by considering an increase in expected credit loss.

The assessment of credit risk, and the estimation of expected credit loss, are required to be unbiased and probability-weighted, and should incorporate all available information which is relevant to the assessment, including information about past events, current conditions and reasonable and supportable forecasts of future events and economic conditions at the reporting date. In addition, the estimation of expected credit loss should take into account the time value of money. As a result, the recognition and measurement of impairment is more forward-looking than under IAS 39 and the resulting impairment charge will tend to be more volatile. It will also tend to result in an increase in the total level of impairment allowances, since all financial assets will be assessed for at least 12-month expected credit loss and the population of financial assets to which lifetime expected credit loss applies is likely to be larger than the population for which there is objective evidence of impairment in accordance with IAS 39.

Financial liabilities

The classification of financial liabilities is essentially unchanged, except that, for certain liabilities measured at fair value, gains or losses relating to changes in the entity's own credit risk are to be included in other comprehensive income;

Hedge accounting

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

Transition

A Group-wide Programme, led jointly by Risk and Finance, commenced work during 2015 to oversee delivery of the requirements for implementation of IFRS 9.

The governance structure includes a Steering Committee mandated to oversee implementation in accordance with the standard, a Technical Approval Group to approve key accounting policy change decisions and an Operating Model Design Authority to approve operating model specifications.

Detailed planning was completed during 2015 and the Design Phase commenced thereafter, with a number of key decisions required over the course of the first few months in 2016. The Programme is structured with various work streams responsible for designing and implementing the end state target operating model, technical accounting interpretations, building and validating IFRS 9 provision models and assessing data and systems requirements.

Classification and measurement of financial assets is not expected to result in any significant changes for the Group. Given that the Group does not fair value its own debt, there is no impact as a result of changes required under IFRS 9. However, due to the complexity of decisions required in relation to impairment, it is not possible at this stage to quantify the potential impact.

This standard is subject to EU endorsement.

IASB Effective Date

Annual periods beginning on or after 1 January 2018

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 1. ACCOUNTING POLICIES (continued)

## 1.17. Prospective accounting changes (continued)

## (e) Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrealised Losses

The amendments in *Recognition of Deferred Tax Assets for Unrealised Losses*, which were issued in January 2016, clarify the following aspects

- Unrealised losses on debt instruments measured at fair value and measured at cost for tax purposes give rise to a deductible temporary difference regardless of whether the debt instrument's holder expects to recover the carrying amount of the debt instrument by sale or by use;
- The carrying amount of an asset does not limit the estimation of probable future taxable profits;
- Estimates for future taxable profits exclude tax deductions resulting from the reversal of deductible temporary differences; and
- An entity assesses a deferred tax asset in combination with other deferred tax assets. Where tax law restricts the utilisation of tax losses, an entity would assess a deferred tax asset in combination with other deferred tax assets of the same type.

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

The amendments are subject to EU endorsement.

IASB Effective Date

Annual periods beginning on or after 1 January 2017

## (f) IFRS 16 Leases

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

Lessor accounting remains largely unchanged and the distinction between operating and finance leases is retained.

These amendments will impact the Bank although the impact has not been identified. The impact will be evaluated in due course.

This standard is subject to EU endorsement.

IASB Effective Date

Annual periods beginning on or after 1 January 2019

## (g) Amendments to IAS 7 – Statement of Cash Flows

The amendments to IAS 7 *Statement of Cash Flows*, which were issued in January 2016, require that the following changes in liabilities arising from financing activities be disclosed to the extent necessary:

- Changes from financing cash flows;
- Changes arising from obtaining or losing control of subsidiaries or other businesses;
- The effect of changes in foreign exchange rates; and
- Other changes.

It also stresses that the new disclosure requirements also relate to changes in financial assets if they meet the definition.

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

The amendments are subject to EU endorsement.

IASB Effective Date

Annual periods beginning on or after 1 January 2017.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

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

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

**(a) Going concern**

The financial statements for the financial year ended 31 December 2015 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment.

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 for the financial year ended 31 December 2015 have been prepared on a going concern basis as the Directors of 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 period of assessment.

In making its assessment, the Directors of AIB Group have considered a wide range of information relating to present and future conditions. These have included financial plans approved by the Board of AIB Group in December 2015 covering the period 2016 to 2018, the Restructuring Plan approved by the European Commission in May 2014, liquidity and funding forecasts, and capital resources projections. These have all been prepared under base and stress scenarios having considered the outlook for the Irish, the eurozone and UK economies. In addition, the Directors of AIB Group have considered the commitment of support provided by the Irish Government.

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

**(b) Loan impairment**

The Bank's accounting policy for impairment of financial assets is set out in accounting policy number 1.9. The provisions for impairment on loans and receivables at 31 December 2015 represent management's best estimate of the losses incurred in the loan portfolios at the reporting date. The estimation of loan losses is inherently uncertain and depends upon many factors, including loan loss trends, portfolio grade profiles, local economic climate, conditions in various industries to which borrowers are exposed, and other external factors such as legal and regulatory requirements.

The management process for the identification of loans requiring provision is underpinned by a series of independent stages, including regular monitoring of credit quality and loan loss provisions by AIB Group credit and risk management. The Bank assesses and approves its provisions on a quarterly basis. A quarterly assessment of provision adequacy is also considered by AIB Group Credit Committee, prior to AIB Group Audit Committee and Board approval being sought.

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

**Specific provisions**

A specific provision is made against an impaired loan when, in the judgement of management, the estimated realisable value, including available security, is expected to fall short of the principal and interest amount outstanding on the loan. A specific provision is set aside based on the estimate of the difference between the present value of future cash flows, and the assets' carrying value.

As the amount of specific provision required is primarily model driven, and based on estimates of the timing and amount of future cash flows, the amount of the Bank's provision is somewhat uncertain, and may not fully reflect the impact of the prevailing market conditions. Underlying assumptions are reviewed and updated on a regular basis. For further details please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on pages 16 and 17 of the Risk management section of this report.

**Incurring but not reported provisions**

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

The total amount of impairment loss in the Bank's non-impaired portfolio, and therefore the adequacy of the IBNR provision is inherently uncertain. Key assumptions underpinning the Bank's estimates of collective and IBNR provisions are regularly reviewed in line with experience. For further details of the potential impact of an increase in the emergence period, please refer to: 'Impact of changes to key assumptions and estimates on the impairment provisions' on pages 16 and 17 of the Risk management section of this report.

**Forbearance**

The Bank has developed a number of forbearance strategies to assist customers experiencing financial difficulties, which involve modifications to contractual repayment terms, in order to improve the recoverability of outstanding debt. Advanced forbearance strategies currently being implemented are subject to high levels of judgement and estimation, which may impact on loan impairment provisions.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

**(c) 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 bank 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 profits to absorb losses carried forward. It requires significant judgements to be made about long-term profitability projections over several future accounting periods 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;
- generation of operating profits before provisions in recent years ; and
- continued profitability in 2015 within the Banks internal medium term financial plan.

The Bank was profitable in 2015 and believes that it will generate profits 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. The Bank has carried out an exercise to determine the likely number of years required to utilise the deferred tax, which indicates the deferred tax asset will be fully utilised within next 2 years.

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.

**(d) Fair value of financial instruments**

The best evidence of fair value is quoted prices in an active market. The absence of quoted prices increases reliance on valuation techniques and requires the use of judgement in the estimation of fair value. This judgement includes but is not limited to: evaluating available market information; determining the cash flows for the instruments; identifying a risk free discount rate and applying an appropriate credit spread.

Valuation techniques that rely to a greater extent on non-observable data require a higher level of management judgement to calculate a fair value than those based wholly on observable data.

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

**(e) Provisions for liabilities and commitments**

AIBMB's accounting policy for provisions for liabilities and commitments is set out in accounting policy number 1.10 'Non-credit risk provisions' in Note 1.

AIBMB recognises liabilities where it has present legal or constructive obligations as a result of past events and it is more likely than not that these obligations will result in an outflow of resources to settle the obligations and the amount can be reliably estimated. Details of the Bank's liabilities and commitments are shown in note 22 to the financial statements.

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

In this regard, the Central Bank of Ireland ('CBI') in December 2015, requested the Irish Banking industry, including AIBMB, to conduct a broad examination of tracker mortgage related issues, comprising of a review of mortgage loan books (including both Owner-Occupier and Buy-to-Let properties and loans that have been redeemed and/or sold), to assess compliance with both contractual and regulatory requirements. These regulatory requirements require the Bank to demonstrate that the customers' interest are protected, that customers are being treated fairly, and in the context of customers' understanding with regard to their entitlement to a tracker rate, to consider information provided and the disclosures made to such customers over time. In situations where customer detriment is identified from this examination, AIBMB is required to provide appropriate redress and compensation in line with the CBI 'Principles for Redress'. The CBI has also indicated that any tax liability that impacted customers may incur, in respect of redress, compensation or other payment by the lender, is to be discharged by the lender. This examination is required to cover the period of time from when AIBMB, commenced offering tracker interest rates to 31 December 2015.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES (continued)

*(e) Provisions for liabilities and commitments (continued)*

AIB Group has instigated a project which is on-going to identify all mortgage loans where customer detriment may have occurred and to determine appropriate redress and compensation in such cases. The recognition of provisions for customer redress and related matters which are included in 'provisions for liabilities and commitments' requires significant levels of judgement and estimation in such cases. The project involves determining the population potentially subject to redress, reviewing the relevant contractual documentation, determining changes that have occurred in the interest rates and computing the financial impact and related accounting of such redress.

At 31 December 2015, AIBMB has provided €50 million where either the interest rates are not in accordance with the relevant contractual documentation or where the Bank will offer revised terms on mortgage accounts. This mainly relates to the refund of interest (difference in interest charged to customers compared to the interest that would have been charged when the tracker rate is applied). The provision also includes amounts for compensating customers, such as reimbursement for the time value of money and other compensation amounts.

Furthermore, AIBMB has recognised a provision of €47 million for (a) the accounting impact of a constructive obligation under IAS 37 for fair value remeasurement losses that will be recognised in areas where the Bank will offer revised terms on mortgage accounts; (b) tax liabilities arising from redress or other compensation which the Bank may be required to discharge on behalf of impacted customers; and (c) other costs associated with the examination.

Validation of the final number of impacted accounts is subject to independent third party assurance and also subject to assessment and challenge by the CBI.

Given the uncertainty attaching to certain of the assumptions and judgements underpinning the above provisions, it is possible that the eventual outcome may differ from the current estimates with a resultant charge/credit to the income statement in future periods.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 3. INTEREST INCOME AND SIMILAR INCOME

	2015 € m	2014 € m
Interest on loans and receivables to customers	563	579
Interest receivable from Allied Irish Banks, p.l.c.	100	90
	<b>663</b>	<b>669</b>

Interest receivable from Allied Irish Banks, p.l.c. is €100m (2014: €90m) and relates to mortgage covered securities hedges (bond swaps).

## 4. INTEREST EXPENSE AND SIMILAR CHARGES

	2015 € m	2014 € m
Interest payable to Allied Irish Banks, p.l.c.	65	154
Interest on debt securities in issue	147	139
	<b>212</b>	<b>293</b>

Included in the interest payable to Allied Irish Banks, p.l.c. is interest payable on one month Euribor funding and other additional funding costs of €49m (2014: €133m), and also interest payable on loan portfolio swaps of €16m (2014: €21m).

## 5. NET TRADING GAIN

	2015 € m	2014 € m
Debt Securities	-	1
	<b>-</b>	<b>1</b>

## 6. OTHER OPERATING INCOME

	2015 € m	2014 € m
Recovery on restructured loans	2	-
	<b>2</b>	<b>-</b>

## 7. ADMINISTRATIVE EXPENSES

	2015 € m	2014 € m
Other administrative expenses	101	3
Amounts payable to Allied Irish Banks, p.l.c. under the Outsourcing and Agency Agreement	60	58
	<b>161</b>	<b>61</b>

Other administrative expenses consists of professional fees €1m (2014: €2m), statutory payments (regulatory payments/ levies) €2m (2014: €1m) and provisions for liabilities & commitments €98m of which €97m relates to provisions for customer redress (2014: €Nil) (see note 2 critical accounting judgements and estimates: (e) provisions for liabilities and commitments)

## Employee Information

	2015	2014
Average no. of employees during year	2	3
No. of employees at end of year	2	3

For the financial year ended 31 December 2015 the average number of employees was 2 (2014: 3). As at 31 December 2015, the Bank had 2 employees.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 7. ADMINISTRATIVE EXPENSES (continued)

*Personnel expenses*

	2015 € m	2014 € m
Wages and salaries	0.2	0.2
Voluntary Severance	0.1	-
Social welfare costs and health insurance	-	-
Retirement benefits	-	-
	<b>0.3</b>	<b>0.2</b>

The personnel expense is borne by AIB and allocated to AIBMB under an Outsourcing and Agency Agreement.

*Auditors remuneration (excluding VAT)*

	2015 € '000	2014 € '000
Statutory Audit of entity financial statements	70	70
Other assurance services	38	37
Tax advisory services	-	-
Other non-audit services	-	-
<b>Total auditors' remuneration</b>	<b>108</b>	<b>107</b>

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

*Directors remuneration*

	2015 € '000	2014 € '000
Fees	35	35
	<b>35</b>	<b>35</b>

No additional remuneration has been made to any individuals employed directly by Allied Irish Banks, p.l.c. for roles discharged as directors of AIB Mortgage Bank. The non-executive directors fees are non-pensionable.

## 8. PROVISIONS FOR IMPAIRMENT OF LOANS AND RECEIVABLES

	2015			2014		
	Specific € m	IBNR € m	Total € m	Specific € m	IBNR € m	Total € m
Balance at start of year	1,641	310	1,951	1,972	329	2,301
Credit to income statement	(165)	(158)	(323)	(81)	(19)	(100)
Amounts written off	(519)	-	(519)	(250)	-	(250)
<b>Balance at end of year</b>	<b>957</b>	<b>152</b>	<b>1,109</b>	<b>1,641</b>	<b>310</b>	<b>1,951</b>

By geographical location and industry sector	2015 € m	2014 € m
Republic of Ireland Home Mortgages	1,109	1,951

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 9. TAXATION

	2015 € m	2014 € m
Origination of temporary differences (note 14)	(77)	(52)
<b>Total tax charge for the period</b>	<b>(77)</b>	<b>(52)</b>

The tax charge €77m (2014: €52m) for the year is at an effective rate of 12.5%, which is the same as the standard Irish corporation tax rate.

	2015 € m	%	2014 € m	%
Operating profit before taxation	615		416	
Corporation tax charge (12.5%)	(77)	12.5	(52)	12.5
<i>Effects of:</i>				
Income taxed at higher rates	-	-	-	-
<b>Tax charge</b>	<b>(77)</b>	<b>12.5</b>	<b>(52)</b>	<b>12.5</b>

## 10. DERIVATIVE 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 "Held for Trading". AIB and the Bank amended the Pool and the Non-Pool Hedge structure in December 2013 to include a one-sided free option for the Bank to terminate the swaps without cost on any reset date.

The Bank also uses interest rate swaps to hedge the mortgage covered securities, converting interest payable from a fixed rate basis to a floating rate basis. Effective fair value hedging relationships 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.

	2015		2014	
	Contract/ Notional Amount € m	Fair Value Asset/ Liability € m	Contract/ Notional Amount € m	Fair Value Asset/ Liability € m
<b>Derivatives classified as trading</b>				
Interest rate swaps	21,074	(1)	22,258	(1)
<b>Derivatives classified as hedging (Debt Securities)</b>				
Interest rate swaps	4,765	249	3,765	329
<b>Total derivatives</b>	<b>25,839</b>	<b>248</b>	<b>26,023</b>	<b>328</b>

The following table represents the underlying principal and gross replacement costs of the Bank's derivatives as at 31 December 2015 and 31 December 2014.

	Residual Maturity 2015				Residual Maturity 2014			
	Within 1 yr € m	1 to 5 yrs € m	Over 5 yrs € m	Total € m	Within 1 yr € m	1 to 5 yrs € m	Over 5 yrs € m	Total € m
<b>Underlying principal amount</b>								
Interest rate contracts	21,574	2,990	1,275	25,839	22,758	2,740	525	26,023
<b>Positive fair value</b>								
Interest rate contracts	7	204	38	249	2	284	43	329



## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 11. LOANS AND RECEIVABLES TO BANKS

	2015 € m	2014 € m
<b>Funds placed with Allied Irish Banks, p.l.c</b>		
Analysed by remaining maturity:		
3 months or less	374	434
<b>Funds placed with Barclays Bank, p.l.c</b>		
Analysed by remaining maturity:		
3 months or less	35	35
	409	469

The balances with Allied Irish Banks, p.l.c. include a balance of €374m (2014: €434m) placed with AIB as collateral for the derivatives. The remaining balances are held by Barclays Bank, p.l.c. and represent the Cash Substitution Pool Assets. Cash substitution pool assets are an Asset Covered Securities Act concept whereby certain assets can be held as part of the Cover Assets Pool.

## 12. LOANS AND RECEIVABLES TO CUSTOMERS

	2015 € m	2014 € m
Analysed by remaining maturity:		
Repayable on demand	2,978	4,635
3 months or less	11	5
1 year or less but over 3 months	83	31
5 years or less but over 1 year	525	455
Greater than 5 years	16,883	16,745
	20,480	21,871
Provisions for impairment of loans and receivables (Note 8)	(1,109)	(1,951)
	19,371	19,920

Amounts repayable on demand includes instances where customers have failed to meet specified repayment terms, and are therefore classified as repayable on demand, in accordance with lending conditions.

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 and by geographical location within the Republic of Ireland.

Interest recognised on impaired loans amounted to €47m (2014: €73m) 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*

	2015 € m	2014 € m
Republic of Ireland		
Home Mortgages (net of provision)	19,371	19,920

## 13. OTHER ASSETS

	2015 € m	2014 € m
Accrued interest	47	44
Other assets	6	5
	53	49

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 14. DEFERRED TAXATION

	2015 € m	2014 € m
Deferred tax assets:		
Unutilised tax losses	78	155
Total gross deferred tax assets	78	155
Deferred tax liabilities:		
Total gross deferred tax liabilities	-	-
Net deferred tax assets	78	155
<i>Analysis of movements in deferred taxation</i>		
	2015 € m	2014 € m
At 1 January	155	207
Income statement (Note 9)	(77)	(52)
At 31 December	78	155

At 31 December 2015 deferred tax assets on tax losses and other temporary differences, net of deferred tax liabilities, totalled €78m (2014: €155m). 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 2015 in the Income Statement consist largely of a writeback of a provision for impairment of loans and receivables.

The Bank continued to be profitable in 2015 and the Directors believe that it will generate profits in the foreseeable future. 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. The Bank has carried out an exercise to determine the likely number of years required to utilise the deferred tax, which indicates the deferred tax asset will be fully utilised within the next 2 years.

## 15. ASSETS HELD FOR SALE

	2015 € m	2014 € m
Repossessed assets	2	-
	2	-

## 16. DEPOSITS BY BANKS

	2015 € m	2014 € m
Allied Irish Banks, p.l.c.	11,650	13,966
	11,650	13,966

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. Included in the funding balance is €1,000m (2014: €1,000m) of repo funding with Allied Irish Banks, p.l.c. AIB Mortgage Bank self-issued covered bonds are first repoed for value with Allied Irish Banks, p.l.c. and then are subject to a sale and repurchase agreement with the ECB.

## 17. CUSTOMER ACCOUNTS

	2015 € m	2014 € m
Current accounts	1	1
	1	1

The customer account balance reflects €1.4m (2014: €0.93m) credits on customer mortgage accounts due to short-term receipts such as payments received in the course of property disposals or mortgage redemptions.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 18. DEBT SECURITIES IN ISSUE

	2015 € m	2014 € m
<i>Mortgage covered securities in issue to external investors of €4.77bn (2014: €3.77bn) and in issue to Allied Irish Banks, p.l.c. of €1.15bn (2014: €1.15bn) by remaining maturity:</i>		
1 year or less	500	500
5 years or less but over 1 year	3,490	3,240
Greater than 5 years	1,925	1,175
Carrying Value of Debt Securities <sup>(1)</sup>	5,915	4,915
<i>Mortgage covered securities in issue to external investors and internal issuances at nominal value:</i>		
External investors	4,765	3,765
Allied Irish Banks, p.l.c.	1,150	1,150
AIB Mortgage Bank *	1,250	2,750
	7,165	7,665

<sup>(1)</sup> The fair value of hedged liability positions is disclosed in Other Liabilities for 2015 and 2014. (See Note 21)

\*Of the total mortgage covered securities in issue to AIB Mortgage Bank of €1.25bn (2014: €2.75bn) the following values have been used in Sale and Repurchase agreement:

	2015 € m	2014 € m
Bond Nominal used for Sale and Repurchase with AIB, p.l.c	1,170	1,070
Liquidity provided under the Sale and Repurchase with AIB, p.l.c	1,000	1,000

Mortgage covered securities issued by AIB Mortgage Bank are first repoed for value with Allied Irish Banks, p.l.c. and then are subject to a sale and repurchase agreement with the ECB, providing liquidity for the Bank and AIB Group.

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 International Accounting Standards Board ("IASB") Framework, no asset or liability has been recognised. The self-issuance of securities is however disclosed above. Self-issuances of mortgage covered securities that are the subject of a sale and repurchase agreement with Allied Irish Banks, p.l.c. by AIB Mortgage Bank give rise to the recognition of an asset and a liability (See Note 16 – Deposits by Banks).

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 2015, the Cover Assets Pool amounted to €13.9bn (2014: €15bn), comprising of €13.9bn (2014: €15bn) of mortgage credit assets (mortgage loan accounts) and €0.04bn (2014: €0.04bn) of substitution assets (cash on deposit with suitably rated credit institutions). Section 40 (2) of the Act requires that the following information be disclosed in respect of mortgage credit assets that are recorded in the register of mortgage covered securities business.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 18. DEBT SECURITIES IN ISSUE (continued)

## (a) Mortgaged properties and principal loan balances outstanding in the cover assets pool

## Total Loan Balances

From	To	Total Loan Balances		Number of Mortgaged Properties	
		2015 (1 & 2) € m	2015	2014 (1 & 2) € m	2014
€0	€100,000	1,975	38,753	1,995	39,177
€100,000	€200,000	5,083	34,853	5,293	36,191
€200,000	€500,000	5,906	21,618	6,647	24,090
Over €500,000		898	1,186	1,089	1,434
		<b>13,862</b>	<b>96,410</b>	<b>15,024</b>	<b>100,892</b>

(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 108,052 loan accounts (2014: 113,666) secured on 96,410 properties (2014: 100,892).

## (b) Geographical location of mortgaged properties in the cover assets pool

Geographical Area	Number of Mortgaged Properties		Number of Mortgaged Properties	
	2015		2014	
Co. Dublin	25,957	27%	26,970	27%
Outside Dublin	70,453	73%	73,922	73%
	<b>96,410</b>	<b>100%</b>	<b>100,892</b>	<b>100%</b>

## (c) Mortgage loan accounts in default in the cover assets pool

As at 31 December 2015, there were no mortgage loan accounts (2014: Nil) in default in the Cover Assets Pool (in default being defined as impaired mortgage loan accounts).

## (d) Mortgage loan accounts in default in the cover assets pool with arrears greater than €1,000

During the financial year ended 31 December 2015, 4 mortgage loan accounts (2014: 15) in the Cover Assets Pool had been in default with arrears greater than €1,000. As at 31 December 2015, there were no accounts in default in the Cover Assets Pool (2014: Nil).

## (e) Replacement of non-performing mortgage loan accounts from the cover assets pool

During the financial year ended 31 December 2015, 92 non-performing mortgage loan accounts (2014: 414) were removed in total from the Cover Assets Pool (For this purpose, non-performing is defined as credit grade 7 and 8, i.e. has the same meaning as in default). These loan accounts were not replaced with other assets as the Cover Assets Pool continued to meet all regulatory requirements.

## (f) Amount of interest in arrears on mortgage loan accounts in the cover assets pool not written off

The total amount in arrears (including principal and interest) in respect of 178 accounts (2014: 273) as at 31 December 2015 was €146,543 (2014: €222,471). €43,993 of this represented non-payment of interest. None of the accounts in question were written off as at 31 December 2015 as they were in arrears for less than three months.

## (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 2015 was €1,740m (2014: €1,702m), of which €1,360m (2014: €1,275m) represented repayment of principal and €380m (2014: €427m) represented payment of interest. The repayments of principal include the repayment of mortgage loan accounts by customers closing their existing accounts when opening a new account.

## (h) Number and amount of mortgage loans in the cover assets pool secured on commercial property

As at 31 December 2015 there were no loan accounts (2014: Nil) in the Cover Assets Pool that were secured on commercial properties.

## 19. ACCRUALS AND DEFERRED INCOME

	2015 € m	2014 € m
Interest payable on mortgage covered securities	69	64
Expenses	-	2
	<b>69</b>	<b>66</b>

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 20. SUBORDINATED LIABILITIES

	2015 € m	2014 € 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 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.

(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 *paripassu* Subordinated Creditors and those creditors of AIB Mortgage Bank whose claims rank or are expressed to rank junior to the claims of AIB.

## 21. OTHER LIABILITIES

	2015 € m	2014 € m
Fair value of hedged liability positions <sup>(1)</sup>	182	267
Items in transit	4	2
	186	269

<sup>(1)</sup> In 2014, the fair value of hedged liability positions was disclosed in Debt Securities in Issue. (See note 18)

## 22. PROVISIONS FOR LIABILITIES AND COMMITMENTS

	2015 € m	2014 € m
Provision for customer redress	97	-
Other provisions	1	-
	98 <sup>(1)</sup>	-

**Provisions for customer redress**

In December 2015, the Central Bank of Ireland ('CBI'), requested the Irish banking industry, including AIBMB, to conduct a broad examination of tracker mortgage related issues, comprising of a review of mortgage loan books (including both Owner-Occupier and Buy-to- Let properties and loans that have been redeemed and/or sold), to assess compliance with both contractual and regulatory requirements. In situations where customer detriment is identified from this examination, AIB is required to provide appropriate redress and compensation in line with the CBI 'Principles for Redress'. AIB Group has instigated a project which is on-going to identify all mortgage loans where customer detriment may have occurred and to determine appropriate redress and compensation in such cases.

At 31 December 2015, AIBMB has provided €50 million where either the interest rates are not in accordance with the relevant contractual documentation or where the Group will offer revised terms on mortgage accounts. This mainly relates to the refund of interest (difference in interest charged to customers compared to the interest that would have been charged when the tracker rate is applied). The provision also includes amounts for compensating customers, such as reimbursement for the time value of money and other compensation amounts.

Furthermore, the Bank has recognised a provision of €47 million for (a) the accounting impact of a constructive obligation under IAS 37 for fair value remeasurement losses that will be recognised in areas where the Bank will offer revised terms on mortgage accounts; (b) tax liabilities arising from redress or other compensation which the Bank may be required to discharge on behalf of impacted customers; and (c) other costs associated with the examination.

Given that the grounds on which the provisions have been estimated could prejudice the position of the Bank, further information as required by IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* is not disclosed.

<sup>(1)</sup> The total provisions for liabilities and commitments expected to be settled within one year amount to €98 million (2014: Nil).

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 23. ISSUED SHARE CAPITAL PRESENTED AS EQUITY

	2015 € m	2014 € m
Authorised:		
3,000,000,000 ordinary shares of €1.00 each (2014: 3,000,000,000 ordinary shares of €1.00 each)	3,000	3,000
Issued and fully paid up:		
1,745,000,000 ordinary shares of €1.00 each (2014: 1,745,000,000 ordinary shares of €1.00 each)	1,745	1,745

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.

## 24. CAPITAL RESERVES

	2015 € m	2014 € m
Opening balance	580	580
Closing balance	580	580

Capital reserves represent cash contribution from Allied Irish Banks, p.l.c.

## 25. CAPITAL MANAGEMENT

## Capital regulation

CRD IV consists of the Capital Requirements Regulation ("CRR") and the Capital Requirements Directive ("CRD"), and is designed to strengthen the regulation of the banking sector and to implement the Basel III agreement in the EU legal framework. CRD IV measures include:

- a single set of harmonised prudential rules which enhanced requirements for quality and quantity of capital; and
- CRD IV also harmonises the deductions from own funds in order to determine the amount of regulatory capital that is prudent to recognise for regulatory purposes. Some of the provisions of CRD IV were introduced on a phased basis from 2014, these typically followed 20% in 2014, 40% in 2015 etc. until 2018. The main exception to this relates to the deduction for the deferred tax asset which will be deducted at 10% per annum commencing in 2015.

AIB commenced reporting to its regulator under the transitional CRD IV rules during 2014. The transitional capital ratios presented on page 6 take account of these phasing arrangements. The fully loaded capital ratios represent the full implementation of CRD IV.

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

The CET1 transitional ratio is significantly in excess of the SSM's minimum CET1 regulatory requirement. (see page 6)

## 26. STATEMENT OF CASH FLOWS

	2015 € m	2014 € m
Loans and receivables to Banks (Note 11)	409	469
	409	469

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

## 27. SEGMENTAL INFORMATION

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

## 28. COMMITMENTS

At 31 December 2015 the Bank had €394m (2014: €349m) of approved mortgage loan applications that had not been drawn down as at the year end.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 29. FAIR VALUE OF FINANCIAL INSTRUMENTS

The term 'financial instruments' includes both financial assets and financial liabilities. The fair value of a financial instrument is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. The Banks' accounting policy for the determination of fair value of financial instruments is set out in accounting policy number 1.6, 1.7 and 1.14.

Readers of these financial statements are advised to use caution when using the data in the following table to evaluate the Bank's financial position or to make comparisons with other institutions. Fair value information is not provided for items that do not meet the definition of a financial instrument such as shareholders' equity. These items are material and accordingly, the fair value information presented does not purport to represent, nor should it be construed to represent, the underlying value of the Bank as a going concern at 31 December 2015.

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

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

**Level 1** – financial assets and liabilities measured using quoted market prices from an active market (unadjusted).

**Level 2** – financial assets and liabilities measured using valuation techniques which use quoted market prices from an active market or measured using quoted market prices unadjusted from an inactive market.

**Level 3** – financial assets and liabilities measured using valuation techniques which use unobservable market data.

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

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

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

*Financial instruments measured at fair value in the financial statements*

*Derivative financial instruments*

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

Counterparty credit and own credit is an input into the valuation of uncollateralised customer derivatives.

*Loans and receivables to banks*

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

*Loans and receivables to customers*

The Bank provides lending facilities of varying rates and maturities to personal customers. Valuation techniques are used in estimating the fair value of loans, primarily using discounted cash flows and applying market rates where practicable.

In addition to the assumptions set out above under valuation techniques regarding cash flows and discount rates, a key assumption for loans and receivables is that the carrying amount of variable rate loans (excluding mortgage products) approximates to market value where there is no significant credit risk of the borrower. The fair value of variable rate mortgage products including tracker mortgages is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in the portfolio. For fixed rate 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 2015 took account of the Banks' expectations on credit losses over the life of the loans.

*Deposits by banks*

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

*Debt securities in issue*

The estimated fair value of subordinated liabilities and other capital instruments, and debt securities in issue, is based on quoted prices where available, or where these are unavailable, are estimated using valuation techniques using observable market data for similar instruments. Where there is no market data for a directly comparable instrument, management judgement, on an appropriate credit spread to similar or related instruments with market data available, is used within the valuation technique. This is supported by cross referencing other similar or related instruments.

*Other financial assets and other financial liabilities*

This caption includes accrued interest receivable and payable and the carrying amount is considered representative of fair value. The following table sets out the carrying value of financial instruments across the three levels of the fair value hierarchy at 31 December 2015:

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 29. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

	2015											
	Carrying amount in statement of financial position					Fair Value hierarchy						
	At fair value through profit and loss		At fair value through OCI		At amortised cost		Total		Level 1	Level 2	Level 3	Total
Held for trading	Fair value hedge derivative	Cash flow hedge derivatives	Loans and receivables	Other	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
<b>Financial assets measured at fair value</b>												
<b>Derivative financial instruments</b>												
Interest Rate Derivatives	-	249	-	-	-	249	-	249	-	-	-	249
<b>Financial assets not measured at fair value</b>												
Loans and receivables to banks <sup>(1)</sup>	-	-	-	409	-	409	-	-	-	-	409	409
Loans and receivables to customers	-	-	-	19,371	-	19,371	-	-	-	-	17,505	17,505
Other financial assets	-	-	-	-	53	53	-	-	-	-	53	53
	-	249	-	19,780	53	20,082	-	249	-	249	17,967	18,216
<b>Financial liabilities measured at fair value</b>												
<b>Derivative financial instruments</b>												
Interest Rate Derivatives	1	-	-	-	-	1	-	-	1	-	-	1
<b>Financial liabilities not measured at fair value</b>												
Deposits by banks	-	-	-	-	11,650	11,650	-	-	-	-	11,650	11,650
Debt securities in issue	-	-	-	-	5,915	5,915	6,142	-	-	-	-	6,142
Subordinated liabilities	-	-	-	-	300	300	-	78	-	-	-	78
Other financial liabilities	-	-	-	-	69	69	-	-	-	-	69	69
	1	-	-	-	17,934	17,935	6,142	79	11,719	79	11,719	17,940

No transfers in or out of Level 3 have occurred during 2015.

<sup>(1)</sup> A reclassification between levels has taken place to be in line with AIB Group treatment.



## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 29. FAIR VALUE OF FINANCIAL INSTRUMENTS (continued)

		2014									
		Carrying amount in statement of financial position						Fair Value hierarchy			
At fair value through profit and loss		At fair value through OCI		At amortised cost		Total					
Held for trading	Fair value hedge derivative	Cash flow hedge derivatives	Loans and receivables	Other		Level 1	Level 2	Level 3	Total		
€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	
<b>Financial assets measured at fair value</b>											
Derivative financial instruments											
-	329	-	-	-	-	-	329	-	329	-	
Interest Rate Derivatives											
<b>Financial assets not measured at fair value</b>											
Loans and receivables to banks <sup>(1)</sup>											
-	-	-	469	-	469	-	-	469	469	-	
Loans and receivables to customers											
-	-	-	19,920	-	19,920	-	-	17,583	17,583	-	
Other financial assets											
-	-	-	-	50	50	-	-	50	50	-	
-	329	-	20,389	50	20,768	-	329	18,102	18,431	-	
<b>Financial liabilities measured at fair value</b>											
Derivative financial instruments											
1	-	-	-	-	-	-	1	-	1	-	
Interest Rate Derivatives											
<b>Financial liabilities not measured at fair value</b>											
Deposits by banks											
-	-	-	-	13,966	13,966	-	-	13,966	13,966	-	
Debt securities in issue											
-	-	-	-	4,915	4,915	5,261	-	-	5,261	-	
Subordinated liabilities											
-	-	-	-	300	300	-	78	-	78	-	
Other financial liabilities											
-	-	-	-	64	64	-	-	64	64	-	
1	-	-	-	19,245	19,246	5,261	79	14,030	19,370	-	

No transfers in or out of Level 3 have occurred during 2014.

<sup>(1)</sup> A reclassification between levels has taken place to be in line with AIB Group treatment.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 30. 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, deposits and derivatives on an arm's length basis. Interest paid to AIB and interest received from AIB is disclosed in Note 3 and Note 4 to the accounts. 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 with the balance of funding being provided by AIB Group. The Bank is also party to the Mortgage-Backed Promissory Note Framework Agreements with the Central Bank of Ireland, however this type of funding has not been utilised since 2011.

*(b) Transactions with key management personnel*

Loans to Key management personnel, namely Executive and Non-Executive Directors and Senior Executive Officers, in office during the year are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons of similar standing not connected with 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 AIB Mortgage Bank generally, in accordance with established policy, within limits set on a case by case basis.

Details of transactions with key management personnel, and connected parties where indicated, for the years ended 31 December 2015 and 2014 are as follows:

*(i) Current Directors*

	Balance at 31 December 2014	Amounts advanced during 2015	Amounts repaid during 2015	Balance at 31 December 2015
	€'000	€'000	€'000	€'000
<b>Catherine Woods</b>				
Loans	79	-	10	69
Interest charged during 2015				1
Maximum debit balance during 2015				79

Gerry Gaffney, Dave Keenan, James Murphy and Jim O'Keeffe had no facilities with AIB Mortgage Bank during 2015.

*(ii) Former Directors who were in office during the year*

	Balance at 31 December 2014	Amounts advanced during 2015	Amounts repaid during 2015	Balance at 31 December 2015
	€'000	€'000	€'000	€'000
<b>Eileen Kelliher</b>				
Loans	264	-	18	246
Interest charged during 2015				3
Maximum debit balance during 2015				264

*(iii) Senior Executive Officers in office during the year*

Senior Executive Officers in office during the year had no facilities with the AIB Mortgage Bank during 2015.

*(iv) Aggregate amounts outstanding at year-end*

	Balance at 31 December 2014	Balance at 31 December 2015
	€'000	€'000
Directors (2015: 2 persons; 2014: 2 persons)	343	314

*(v) Connected Persons*

There were no loans to connected persons of directors in office as at 31 December 2015 (2014: Nil), as defined in Section 220 of the Companies Act 2014 and in accordance with conditions attached to AIB Mortgage Bank banking licence.

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.

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 30. RELATED PARTY TRANSACTIONS (continued)

*(c) Funding Support*

As at 31 December 2015 the mortgage covered securities issued to AIB Mortgage Bank were €1.3bn (2014:€2.8bn). Of these, €1.2bn (2014: €1.1bn) were first repoed for a value of €1.0bn (2014: €1.1bn) with Allied Irish Banks, p.l.c. and then were subject to a sale and repurchase agreement with the ECB, to provide liquidity for AIB Group.

As at 31 December 2015 the mortgage covered securities issued to Allied Irish Banks, p.l.c. were €1.2bn (2014: €1.2bn).

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 facility with the Central Bank, outside of normal ECB open market operations, has not been used since April 2011.

*(d) 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 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 loan accounts at 31 December 2015 was €21.1bn (2014: €22.3bn).

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 2015 was €4.8bn (2014: €3.8bn).

*(e) Summary of the AIB Group relationship with the Irish Government*

The Irish Government, as a result of both its investment in AIB's 2009 Preference shares and AIB's participation in Government guarantee schemes, became a related party of AIB in 2009. Following the various ordinary/CNV share issues to the NPRFC<sup>(1)</sup> during 2010 and 2011, AIB is under the control of the Irish Government.

AIB enters into normal banking transactions with the Irish Government and many of its controlled bodies on an arm's length basis. In addition, other transactions include the payment of taxes, pay related social insurance, local authority rates, and the payment of regulatory fees, as appropriate. Following the crisis in the Irish banking sector and the stabilisation measures adopted since 2008, the involvement of the Irish Government in AIB and in other Irish banks has been and continues to be considerable. This involvement is outlined below.

<sup>(1)</sup>Transferred to the Ireland Strategic Investment Fund ("ISIF") on 22 December 2014. Ownership of ISIF vests with the Minister for Finance and is controlled and managed by the NTMA.

*Rights and powers of the Irish Government and the Central Bank of Ireland.*

The Irish Minister for Finance ("the Minister") and the Central Bank of Ireland ("the Central Bank") have significant 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 AIB Group of its shares;
- The manner in which AIB Group extends credit to certain customer groups; and
- Conditions regulating the commercial conduct of Allied Irish Banks, p.l.c, having regard to capital ratios, market share and the Group's balance sheet growth.

In addition, various other initiatives such as strategies/codes of conduct for dealing with mortgage and other consumer/business loan arrears are set out in the Risk section of this report.

The relationship of the Irish Government with AIB is outlined under the following headings:

- Guarantee schemes;
- Funding support;
- PCAR/PLAR;
- Credit Institutions (Stabilisation) Act 2010:
  - (i) Direction Order;
  - (ii) Transfer Order;
  - (iii) Subordinated Liabilities Order;
- Central Bank and Credit Institutions (Resolution) Act 2011; and
- Relationship framework which was signed in March 2012.

In addition, the European Commission, in approving AIB's restructuring plan on 7 May 2014, found that restructuring aid granted by Ireland to AIB is in line with EU state aid rules

*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

## NOTES TO THE FINANCIAL STATEMENTS (continued)

## 30. RELATED PARTY TRANSACTIONS (continued)

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

Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 ("ELG Scheme") which expired on 28 March 2013 for all new liabilities and is outlined below.

*- ELG Scheme*

On 21 January 2010, Allied Irish Banks, p.l.c., including its international branches and subsidiaries, AIB Group (UK) p.l.c., 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. On 28 March 2013, the ELG Scheme ended for all new liabilities. After this date, no new liabilities are guaranteed under this scheme.

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 2015 amounted to €1.8 billion (€4.6 billion at 31 December 2014).

*- Funding support*

Throughout the financial crisis, the Irish Government provided guarantees under the CIFS (expired September 2010) and ELG Schemes.

In addition, through the Central Bank, the Irish Government provides direct funding as follows:

AIB Group has borrowings from the Central Bank as part of Eurosystem. These borrowings are under ECB Monetary Policy Operation Sale and Repurchase Agreements and at 31 December 2015 amount to € 2.9 billion (2014: € 3.4 billion) of which € 1.9 billion was in the Targeted Long Term Refinancing Operation ("TLTRO"). The interest rates on these facilities are set by the Central Bank and advised to AIB. The interest rate on the facilities above is set by the Central Bank and advised to AIB on each rollover date and at 31 December 2015 was 0.05 %, being the ECB refinancing rate at that date. The facilities mature within 1 week, apart from the TLTRO which will mature between September 2016 and September 2018 depending on eligible lending activities in excess of specific benchmarks.

*- 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.

*- Credit Institutions (Stabilisation) Act 2010*

The Credit Institutions (Stabilisation) Act 2010, which was enacted in December 2010, ceased to have effect on 31 December 2014. During the period when the Act was effective, the Minister invoked certain of his powers under the Act in relation to AIB as follows:

- A Direction Order in December 2010;
- A Transfer Order in February 2011;
- A Subordinated Liabilities Order in April 2011; and
- Acquisition of EBS Limited (EBS").

On 31 March 2011, the Minister proposed the combination of AIB and EBS (formerly EBS Building Society) to form one of the two 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.

*- 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. On 28 September 2012, the Minister made the Credit institutions Resolution Fund Levy Regulations, 2012 providing for contributions, by authorised credit institutions, to a Credit Institutions Resolution Fund pursuant to Section 15 of the Central Bank and Credit Institutions (Resolution) Act 2011. This Resolution Fund has been designed to provide a source of funding for the resolution of financial instability in, or of an imminent serious threat to the financial stability of an authorised credit institution. 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 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.

**NOTES TO THE FINANCIAL STATEMENTS (continued)****30. RELATED PARTY TRANSACTIONS (continued)***(e) Summary of the AIB Group relationship with the Irish Government (continued)*

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.

*- 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.

*- Restructuring Plan commitments*

AIB has committed to a range of measures relating to customers in difficulty: cost caps and reductions; acquisitions and exposures; coupon payments; promoting competition; and the repayment of aid to the State. All of the commitments are aligned to AIB's operational plans and are supportive of AIB's return to viability.

**31. SUBSEQUENT EVENTS**

AIBMB issued new 7 year Asset Covered Securities on 4th February 2016 at a coupon of 0.875% per annum fixed at a net price of 99.441%. The proceeds were utilised to reduce the borrowings from AIB p.l.c.

**32. APPROVAL OF FINANCIAL STATEMENTS**

The financial statements were approved by the Directors on 15 March 2016.