AIB Mortgage Bank Unlimited Company

Directors' Report and
Annual Financial Statements
for the financial year ended 31 December 2020

Contents

Directors and other information

Directors	Simon Ball	Independent Non-Executive Director and Deputy Chair
	Chris Curley	Executive Director
	Gerry Gaffney	Executive Director
	Yvonne Hill	Independent Non-Executive Director
	Conor McGrath	Executive Director (Managing)
	James Murphy	AIB Group Non-Executive Director
	Paul Owens	Independent Non-Executive Director
Secretary	Diane Lumsden	Company Secretary
Registered office	10 Molesworth Street Dublin 2 Ireland	
Registered number	404926	
Registered auditor	Deloitte Ireland LLP Chartered Accountants & Statutory Audit Firm Deloitte & Touche House Earlsfort Terrace Dublin 2 Ireland	
Banker	Allied Irish Banks, p.l.c.	
Solicitor	Helen Dooley Group General Counsel Allied Irish Banks, p.l.c. 10 Molesworth Street Dublin 2 Ireland	
Cover-assets monitor	Mazars Harcourt Centre Block 3 Harcourt Road Dublin 2 Ireland	

Directors' report

The Directors of AIB Mortgage Bank Unlimited Company (the "Bank") present their Directors' report (the "Report") and audited financial statements for the financial year ended 31 December 2020. The Directors' responsibility statement in relation to the financial statements is on page 51.

Principal activities
The Bank, a public unlimited company, obtained an Irish banking licence under the Irish Central Bank Act, 1971 (as amended) and was registered as a designated mortgage credit institution under the Asset Covered Securities Act, 2001 on 8 February 2006.

The Bank is a wholly owned subsidiary of Allied Irish Banks, p.l.c. ('AIB'). The ultimate parent company of the Bank and AIB is AIB Group plc ('AIB Group' or 'the Group').

The Bank's principal objective is to issue mortgage covered securities for the purpose of financing mortgage loans secured on residential property in accordance with the Asset Covered Securities Act, 2001 and the Asset Covered Securities (Amendment) Act 2007 ('the Asset Covered Securities Acts'). Such mortgage loans may be made directly by the Bank or may be purchased from AIB and other subsidiary undertakings of AIB or third parties. The Bank's debt securities are listed on the main securities market of Euronext Dublin.

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

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

The majority 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
Corporate Governance Requirements

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

The Bank is subject to the provisions of the Central Bank of Ireland Corporate Governance Requirements for Credit Institutions 2015 ("the Requirements"), which imposes minimum core standards upon all credit institutions licensed or authorised by the CBI. The Bank is designated as a "high impact institution" for the purposes of the Requirements. The Bank sought and received derogations from a number of the obligations imposed on high impact institutions, namely:

- Derogation granted from the requirement for the Board to have seven directors on the basis that it continues to be of sufficient size and expertise to oversee adequately the operations of the credit institution.
- Derogation granted from the requirement for the Board to have at least three independent non-executive directors ('INEDs') on the basis that the Board continues to have at least 2 independent INEDs.
- Derogation granted from the requirement to have an external evaluation of Board effectiveness carried out every three years, on the basis that the Bank continues to conduct an internal review of its own performance and that of its individual directors annually and that this exercise is led by the Chairman.
- Derogation granted from the requirement for the Board to meet at least six times per calendar year, on the basis that the Board will continue to meet at least four times per calendar year and at least once every quarter.
- Derogation granted to rely on the following AIB Committees: AIB Board Risk Committee, AIB Remuneration Committee and AIB Nomination and Corporate Governance Committee.
- Derogation granted from the requirement for cross committee membership on the basis that the Bank has only one sub-committee.
- The Bank has received approval from the CBI that the Chief Risk Officer ('CRO') of AIB Group acts as the CRO of the Bank on an outsourced basis and a Designated Risk Representative ('DRR') has been appointed for the Bank for maintaining and monitoring the effectiveness of the credit institution's risk management system. The appointed DRR has a direct reporting line to the CRO.

Corporate governance
Corporate Governance Requirements (continued)
Compliance with the Requirements

- As noted above there should be a minimum of two Is INEDs on the Board (Requirement 7.2 of the Requirements). Following the resignation of Catherine Woods on 31 December 2019 until the appointment of Yvonne Hill and Paul Owens on 4 February 2020 the Board for a short period comprised of less than the minimum number of INEDs. The Bank was also non-compliant with Requirements 22.1, 22.2 and 22.3 of the Requirements as the Audit Committee had fewer than the minimum three members, did not have a majority of INEDs, and had no Chairman.
- Following the resignation of Dave Keenan on 25 June 2020, the Bank is non-compliant with Requirements 8.1 and 8.5 of the Requirements, as it does not have a Chairman in place. However on 25 June 2020, Simon Ball was appointed Deputy Chairman, until such time as the Chairman's successor is appointed. While the Bank's operations were not materially impacted by the above mentioned instances of non-compliance with the Requirements, it commits to and is actively engaged in ensuring compliance with the CBI's licence requirements.
- The Bank notified the CBI of all instances of non-compliance with the Requirements, within the required timeframe. Interim governance arrangements for the Chair were put in place there was no known negative impact on the governance and financial position of the Bank, nor was there deemed to be any poor outcomes for its customers as a result.
- The Bank was deemed to be materially compliant with the provisions of the Requirements throughout 2020.

The Board of Directors

Board of Directors and Secretaries composition and changes during 2020:

Directors	**Role**	**Date appointed**	**Date resigned**
Simon Ball*	Independent Non-Executive Director		
Ken Burke**	Managing Director		
Chris Curley	Executive Director		
Gerry Gaffney	Executive Director		
Yvonne Hill	Independent Non-Executive Director	4 February 2020	
James Murphy	Group Non-Executive Director		
Paul Owens	Independent Non-Executive Director	4 February 2020	
Dave Keenan	Chair and Group Non-Executive Director		25 June 2020
Secretaries			
Diane Lumsden	Company Secretary		
Brian Kearns	Joint Secretary		11 December 2020
Conor Gouldson	Assistant Secretary	23 March 2020	
Aeilish McGovern	Assistant Secretary	23 March 2020	

* Simon Ball was appointed as Deputy Chairman on 26 June 2020.
** On 12 February 2021 Ken Burke resigned and was replaced by Conor McGrath as Managing Director of the Bank.

Governance is exercised through a Board of Directors ("the Board") and a senior management team. The Board is responsible for corporate governance encompassing leadership, direction and control of the Bank and is responsible for financial performance to its shareholder and ultimate parent AIB Group plc.

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 ('RAS'), approves the Risk Framework and the annual financial plans. The Bank benefits as a subsidiary of AIB from the wider AIB governance and operating structure, such as oversight of audit and risk related activities. AIB provides services to the Bank through an Outsourcing and Agency Agreement, updates in respect of the performance against agreed service levels which are provided to the Board regularly.

In the event that material failings or weaknesses in the systems of risk management or internal control are identified, an explanation of the issue and an assessment of its impact is presented to the Board together with a proposed remediation plan. 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.

Corporate governance

The Board of Directors (continued)

The Bank has robust governance arrangements, which include a clear organisational structure with well defined, transparent, and consistent lines of responsibility, effective processes to identify, manage, monitor and report the risks to which it is or might be exposed, and adequate internal controls, including sound administrative and accounting procedures, IT systems and controls. The Board receives regular updates on the Bank's risk profile through the quarterly risk report and, during 2020, considered the outcome of internal and external audit activities.

Financial reporting processes

The Board, supported by the Audit Committee, rely on AIB‘s internal control and risk management systems in relation to the financial reporting process. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Bank's financial reporting objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The Board, through AIB’s established processes regarding internal control and risk management systems ensures effective oversight of the financial reporting process. The Bank's overall control system around the financial reporting process includes:

- clearly defined organisation structure and authority levels with reporting mechanisms to the Board;
- a comprehensive set of policies and procedures, in line with AIB, relating to the controls around financial reporting and the process of preparing the financial statements; and
- ensuring the integrity of the financial statements and the accounting policies therein.

The Board evaluates and discusses significant accounting and reporting issues as the need arises.

Audit Committee

In accordance with section 167 of the Companies Act 2014 and Requirement 19.1 of the Requirements, the Directors confirm that an Audit Committee (“the Committee”) is established. The Board is assisted in the discharge of its duties by this Committee which is composed of four Non-Executive Directors and which operates under Terms of Reference approved by the Board. Simon Ball, Yvonne Hill (Chair) and Paul Owens are INEDs, and possess the requisite degree of independence so as to be able to contribute effectively to the Committee's functions. James Murphy is deemed to be a Non-Executive Director by virtue of the role he fulfils in an area of AIB unrelated to the Bank's operations.

During 2020, the Committee, had oversight responsibility for audit matters including, inter alia:

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

These responsibilities are discharged through its meetings with and receipt of reports from management including Group Finance, Group Internal Audit, Group Risk and Group Compliance. During 2020, the Committee met on four occasions and, amongst other activities, the Committee reviewed the Bank's annual financial statements and related accounting policies, key judgements and practices; reports on compliance; the effectiveness of internal controls; including the effectiveness of controls operated under the Outsourcing and Agency Agreement; 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 was effective.

The Committee ensures that appropriate measures are taken into consideration and addresses control issues identified by Internal Audit and the Auditor.

The Audit Committee Chair engaged with the AIB Group Board Audit Committee, and attended the December 2020 Group Board Audit Committee meeting, and provided an update on the key themes and discussions at the Audit Committee meetings for the period December 2019 to December 2020.

Results for the financial year

The profit before taxation ('PBT') for 2020 amounted to €23m (2019: €105m), as set out on income statement page 61.

The reduction in reported PBT is due to the implementation of an updated pricing agreement between the Bank and AIB ('the Agreement'), based on the Transactional Net Margin Method, for 2020 to reflect revised OECD guidelines on transfer pricing, which are the internationally accepted principles in this area, and which take account of the functions, risks and assets involved. For 2020 this required a net payment of €74m by the Bank to AIB (2019: net receipt by the Bank from AIB of €197m).

Net Interest Income increased to €360m for 2020, from €311m in 2019. The increase is driven by lower funding costs.

Results for the financial year (continued)
Other Income decreased to €9m in 2020 from €184m in 2019,a reduction of €175m as the fee income received under the Agreement with AIB in 2020 was nil (2019: €197m) and net gain on derecognition relating to final settlement of 2019 loan sales €3m (2019: €17m loss).

Administrative Expenses decreased to €233m in 2020, from €393m in 2019, a reduction of €160m. The majority of this decrease was driven by a reduction of €233m in provisions relating to the Financial Services and Pensions Ombudsman ('FSPO') decision relating to tracker mortgage customers in 2019, offset by the 2020 charge under the Agreement with AIB of €74m (2019: nil).

Net Credit Impairment charge was €113m in 2020 compared to a €3m writeback in 2019, an increase of €116m. The net credit impairment charge of €113m in 2020 is predominately due to post model adjustments for expected COVID-19 impacts and changes to the macroeconomic scenarios as a result of the deterioration in the economic outlook. The net credit impairment charge for 2020 reflected a net remeasurement of expected credit loss ('ECL') allowance charge of €128m, offset by recoveries of amounts previously written-off of €15m. There was a net credit impairment writeback of €3m in 2019 comprising of a €16m charge on loans and advances to customers, offset by recoveries of amounts previously written-off of €19m. For further information see pages 12 to 41 in the Risk Management section.

Business review
The Bank's business has been adversely affected by the COVID-19 pandemic which triggered a global recession in 2020. In Ireland, whilst the hit to the economy was mitigated to some extent by the continuing strength of exports, most notably from the multi-national sector, there was a marked contraction in the domestic economy.

The recession in 2020 saw employment contract and unemployment rise. Some sectors were very hard hit by the restrictions on activity, in particular, hospitality, tourism, travel, live entertainment, non-essential retail and some personal services. At one stage in the year, the unemployment rates including those on pandemic unemployment payments, rose to close on 30%, although the official unemployment rate remained much lower, ending the year at 5.8% (Source: Central Statistics Office 'CSO').

House building activity held up better than expected in 2020, with CSO data putting house completions at 20,676 for the year, down only modestly on the 2019 number of 21,241. Meanwhile, CSO data show that construction output fell by 16.5% in the first three quarters of the year.

Meanwhile, the recession appears to have had just a modest impact on house prices. The latest CSO data show prices have increased by 2.2% year-on-year in 2020.

Total mortgage market new lending drawdowns in Ireland were €8.4bn in 2020 compared with €9.5bn in 2019 (Source: Banking and Payments Federation Ireland).

The impact of the above factors on the Bank's financial performance is reflected in a significant increase in the Bank's expected credit loss estimates of €320m (2019: €210m) due to the deterioration in the economic outlook and negative impact on credit quality, particularly for customers exposed to employment sectors impacted by the COVID-19 restrictions.

COVID-19 has had a pervasive impact on the Bank's operations as well as the Bank's customers' businesses and livelihoods. During 2020, the Bank's priorities have been to support customers, maintain strong capital position and improve operational resilience. To that end, the Bank approved c.12k payment breaks. The Bank has engaged actively with customers during this period, with the vast majority of impacted customers, 91%, having returned to normal payment schedules by December 2020. To facilitate customers, the Bank has ensured that digital channels have been enhanced to provide wider supports.

The Group, have prepared extensively for the UK's exit from the European Union since the Brexit vote in 2016. While the Bank has not experienced any negative impact to its position so far, monitoring for any potential impacts is continuing. However, given the nature of the Bank's business, ROI residential mortgages, any impact is expected to be minimal.

The Bank's loan portfolio before loss allowance decreased by 1.5% during 2020 to €17.5bn as at 31 December 2020 principally because repayments exceeded loans granted of €1.6bn during the year (2019: decrease of 2.5%).

The Bank's residential mortgage portfolio comprises €15.7bn Owner-Occupier (2019: €15.7bn) and €1.8bn Buy-To-Let mortgages (2019: €2.0bn).

Business review

FSPO Decision

The provision at 31 December 2020 for customer redress and compensation and other related costs amounted to €68m (31 December 2019: €229m) in respect of FSPO decision related to Tracker mortgages.

Following a complaint to the Financial Services and Pensions Ombudsman ('FSPO') by a customer from the '06-09 Terms & Conditions ('Ts & Cs') who never had a tracker' cohort, the Group received a preliminary decision in January 2020 which found that the Bank had breached the terms of the customer's mortgage loan contract and directed it to remedy the matter in what the FSPO believed was a fair and proportionate manner. The Bank considered this preliminary decision and recorded a provision of €229m as at 31 December 2019 based on an initial assessment of the likelihood that the same remedy may be due to all customers in this cohort.

The Group subsequently received the FSPO's final decision and decided to accept the decision in full and furthermore decided to apply the remedy to all other customers within this cohort, with payments to customers commencing in July 2020 (Further information with regard to the FSPO decision is detailed in note 24: Provisions for liabilities and commitments).

Asset Quality

Non-performing loans reduced from €1.0bn at 31 December 2019 to €0.9bn at 31 December 2020. This reduction was achieved through redemptions and repayments from customers.

Expected credit loss provisions are €0.3bn (2019: €0.2bn). The impact of the effects of the COVID-19 pandemic on the asset quality profile were continually evaluated and resulted in a significant increase to the Bank's ECL levels.

The Bank has outsourced the management of and servicing of its mortgage portfolio to AIB. AIB has credit policies and strategies, implementation guidelines and monitoring structures in place to manage the Bank's mortgage portfolio, including restructured loans. AIB regularly reviews the performance of these restructured loans and has a dedicated team to focus on asset sales within the restructured portfolio.

AIB will continue to implement sustainable solutions for customers who engage with the Bank, where feasible. AIB continues to review all options in relation to reducing impaired loans including sales and strategic initiatives.

In the period end February 2021, the Bank agreed to sell non-performing loans in long-term default with a gross carrying value of c. €0.2bn for a cash consideration of approximately €0.2bn.

Funding activities

There was a very favourable technical market backdrop for covered bonds in 2020. The European Central Bank ('ECB') has ended net new purchases but is continuing to reinvest funds from maturing bond under the covered bond purchase programme ('CBPP3'). The ECB has been buying bonds in both the primary and secondary markets during the year. CBPP3 is aimed at enhancing the functioning of the monetary policy transmission mechanism, supporting financing conditions in the euro area, and facilitating credit provision to the real economy. As of 8 January 2021, the holdings under CBPP3 were c. €288bn (end Jan 2020: c. €267bn). The ECB forward guidance indicates that interest rates will remain at their current very low levels but it is undergoing a strategic review of policy under its new chairperson. The ECB deposit rate stands at a negative 0.5% at 31 December 2020.

Covered bond spreads tightened over the course of 2020, as the overall technical backdrop remained very supportive and with large amounts of excess liquidity in the financial system there was an appetite for assets across the credit curve. The Bank did not issue covered bonds to external market investors in 2020 in line with AIB's overall funding priorities and plan.

At 31 December 2020, the total amount of principal outstanding in respect of mortgage covered securities issued was €10,675m (31 December 2019: €9,425m), of which €2,275m was held by external debt investors (31 December 2019: €3,025m) and €8,400m by AIB (31 December 2019: €6,400m).

In January 2020, the Bank issued €2,000m (2019: nil) of retained covered bonds with a weighted average tenor of 7.1 years. In July 2020 covered bonds with a nominal value of €750m were redeemed.

Funding activities (continued)
The ratings as at 31 December 2020 for the Bank's Covered Bond Programme, AIB and Ireland are shown below:

Rating Agency	AIB Mortgage Bank Covered Bond Programme	AIB Issuer default rating	Ireland (Sovereign)
Moody's	Aaa	Baa2 (negative outlook)	A2
Standard & Poor's	AAA	BBB (negative outlook)	AA-

In addition to covered bonds the Bank is funded by deposits by banks being borrowings from its parent AIB. The balance at December 2020 was €4,914m (2019: €6,492m) a reduction of €1,578m. The reduction is primarily driven by the net increase in bonds in issue of €1,250m and reduction loans & advance to customers of €369m.

Share Capital
The share capital of the Bank is €436m (2019: €436m), comprised of 1,745m ordinary shares of €0.25 each (2019: comprised of ordinary shares of €0.25 each). Information on the structure of the Bank's share capital, including the rights and obligations attaching to each class of shares, is set out in note 26 to the financial statements.

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

The Bank's minimum Common Equity Tier 1 ('CET1') requirement is 10.5%, comprised of a Pillar 1 requirement of 8%, Capital Conservation Buffer ('CCB') of 2.5%. The Countercyclical Capital Buffer ('CCyB') was reset from 1% to 0% effective 01 April 2020.

At 31 December 2020, the fully loaded CET1 ratio was 21.3% (2019: 25.1%). The fully loaded total capital ratio was 26.3% (2019: 30.9%). The decrease is driven by lower Risk Weighted Assets ('RWAs'). For detail see TRIM paragraph below.

At 31 December 2020, the transitional CET1 ratio was 21.7% (2019: 25.6%), the transitional total capital ratio was 26.6% (2019: 31.5%).

Targeted Review of Internal Models ('TRIM')
The ECB's TRIM Model with respect to the Bank's mortgages has been completed and is now included in end of year reporting. The final ECB TRIM decision on the Bank's Mortgage model resulted in a €1.3bn increase in RWAs. The impact on the Fully loaded CET1 was a decrease of 5.7%.

Minimum Requirement for Own Funds and Eligible Liabilities ('MREL')
At 31 December 2020 the Bank has an MREL ratio of 26.6% of RWAs.

The Single Resolution Board ('SRB') has provided the Bank with its default formula for the MREL target calibration under the new Bank Recovery and Resolution Directive ('BRRD II') legislative framework to be complied with by 1 January 2022. The Bank has estimated it's January 2022 intermediate binding target is 18.3% of RWA including the combined buffer requirement.

Leverage ratio
The leverage ratio at 31 December 2020 was 7.2% (2019: 7.0%) on a fully loaded basis and 7.3% (2019: 7.1%) on a transitional basis.

Risk management
The Bank adopts the same risk management framework and risk mitigation initiatives as AIB. The risk management framework provides a Group-wide definition of risk and lays down principles of how risk is to be identified, assessed, measured, monitored and controlled/mitigated, and the associated allocation of capital against same. The Bank has adapted its credit risk management operating model, including its underlying credit processes, in response to COVID-19. Further information in relation to risk management, including the principal risks and uncertainties facing the Bank, as required under the terms of the European accounts Modernisation Directive (2003/51/EEC) (implemented in Ireland by the European Communities (International Financial Reporting Standards and Miscellaneous Amendments) Regulations 2005) is set out in the risk management report on pages 12 to 50.

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

Outlook for 2021
In terms of economic outlook, the return to lockdown at the start of 2021 has delayed the recovery. However, the conclusion of an EU-UK Free Trade Agreement and the approval and roll-out of COVID-19 vaccines were two positive developments in late 2020. While it will be the second half of 2021 before the vaccines become widely available, it does provide the foundation for a strong sustained recovery as the year progresses.

A priority for the Bank will be to continue to support mortgage customers who experience financial difficulties by offering appropriate solutions. Further sales of portfolios of non-performing loans in 2021 is expected to improve the overall credit quality of the Bank's loan book.

The European Commission has proposed a dedicated EU framework for covered bond harmonisation incorporating a Covered Bond Directive to be transposed into national law by June 2021. The Banking & Payments Federation Ireland's ACS group has engaged with the Department of Finance regarding the transposition of the directive and the relevant amendments to the ACS Act that will be required. The Bank continues to monitor this progress and will seek to comply with any regulation updates in the future.

Sustainability and Climate Change
The Bank recognises the importance of focusing on Sustainability and Climate Change. The Bank as a subsidiary of AIB have committed to being a leader in the necessary transition to a low-carbon economy and they continue to integrate climate risk into its overall risk management approach and broader sustainability strategy. AIB maintains oversight of climate-related metrics on the AIB Group Scorecard and is committed to ensuring operations will be carbon neutral by 2030.

In support of AIB's sustainability strategy the Bank launched a new Green 5 year fixed rate mortgage available to new and existing owner occupier customers.

Going concern
The financial statements for the financial year ended 31 December 2020 have been prepared on a going concern basis as the Directors are satisfied, having considered the risks & uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment of twelve months from the date of approval of these financial statements.

The Bank is dependent on AIB for continued funding and is therefore dependent on the going concern status of the parent. The financial statements of AIB have been prepared on a going concern basis.

In making their assessment, the Directors of AIB have considered a wide range of information relating to present and future conditions, including internally generated stress scenarios, cognisant of the prolonged impacts of COVID-19 and Brexit. The period of assessment used by the Directors of AIB is 12 months from the date of approval of these annual financial statements.

In addition, the Directors of the Bank considered the principal risks and uncertainties which could materially affect the Bank's future business performance and profitability and which are outlined on pages 12 to 50. A stress test was also completed and considered showing that the Bank can deliver on the proposed financial plan covering the period 2021-2023 in both Base and Stress scenarios.

Going concern (continued)
There is no intention to liquidate the company or cease trading and the Bank is not aware of any material uncertainties related to conditions or events that may cast significant doubt upon the company's ability to continue as a going concern. In addition, the Bank's parent AIB has provided a letter of financial support to the Directors.

On the basis of the continued availability of funding from AIB to the Bank, the Board approved financial plans 2021 - 2023 in base and stress scenarios, and notwithstanding the impact of COVID-19 on the performance of the Bank, the Directors of the Bank believe that it is appropriate to prepare the financial statements on a going concern basis.

Directors' and Secretaries interests in shares
The Directors' and Bank Secretaries did not hold any interests in the Bank's shares or debentures at the beginning of the year, during the year or at the year end, pursuant to Section 267 and 329 of the Companies Act 2014.

Shares held in the ultimate parent company AIB Group plc were below 1% of the issued share capital and not disclosable pursuant to Section 260 of the Companies Act 2014.

Share options
Share options were not granted or exercised during the year. Independent Non-Executive Directors do not participate in share option schemes.

Long term incentive plans
There were no conditional grants of awards of ordinary shares outstanding to Executive Directors or the Bank Secretary at 31 December 2020. Independent Non-Executive Directors do not participate in long term incentive plans.

Attendance at Board and Audit Committee Meetings during 2020

Name	Board (Scheduled)		Board (Out of Course)		Board Audit Committee (Scheduled and Out of Course)	
Directors	**Eligible to Attend**	**Attended**	**Eligible to Attend**	**Attended**	**Eligible to Attend**	**Attended**
Ken Burke	4	4	2	2	—	—
Gerry Gaffney	4	4	2	2	—	—
Dave Keenan	1	—	1	1	—	—
Simon Ball	4	4	2	2	4	4
James Murphy	4	4	2	2	4	3
Chris Curley	4	4	2	2	—	—
Yvonne Hill	4	4	1	1	4	4
Paul Owens	4	4	1	1	4	4

Accounting policies
The principal accounting policies, together with the basis of preparation of the financial statements, are set out in note 1 to the financial statements.

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

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

Disclosure notice under section 33AK of the Central Bank Act 1942
The Bank did not receive a Disclosure Notice under Section 33AK of the Central Bank Act 1942 during 2020.

Adequate accounting records
The Directors have complied with the requirements of Sections 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 the Bank by AIB. The accounting records of the Bank are maintained at the registered office of its ultimate parent at AIB Group plc, 10 Molesworth Street, Dublin 2, Ireland.

Directors' report

Non-adjusting events after the reporting period
In the period end February 2021, the Bank agreed to sell non-performing loans in long-term default with a gross carrying value of c. €0.2bn for a cash consideration of approximately €0.2bn.

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

Statement of relevant audit information
Each of the persons who is a Director at the date of approval of this report confirms that:

(a) so far as the Director is aware, there is no relevant audit information of which the Bank's Auditors are unaware; and

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

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

Independent auditor
Deloitte Ireland LLP, Chartered Accountants & Statutory Audit Firm were appointed as auditors on 28 June 2013 and have expressed their willingness to continue in office under Section 383(2) of the Companies Act, 2014.

On behalf of the Board

Conor McGrath
Executive Director (Managing)

Yvonne Hill
Independent Non-Executive Director

Date: 3 March 2021

Risk management report

1. Introduction

All of the Bank's activities involve, to varying degrees, the measurement, evaluation, acceptance and management of risks which are assessed across the Group. Certain risks can be mitigated by the use of safeguards and appropriate systems and actions which form part of the Group's Risk Management Framework. The Bank experiences similar risks and uncertainties facing the Group and adopts the same risk mitigation initiatives as the Group.

2. Risk management framework

The Bank relies on the Group's framework and its supporting policies, processes and governance. For more information on the operation of the Board of the Bank see pages 3 to 5 of this Report.

AIB Group's Risk Management Framework has proven to be resilient throughout 2020 despite the impact of COVID-19 requiring major operational and business changes being implemented to support customers.

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 Group's material risk assessment process and which are relevant to the Bank:

3.1 Credit risk;
3.2 Funding and liquidity risk;
3.3 Capital adequacy risk;
3.4 Financial risk - Market risk;
3.5 Operational risk;
3.6 Regulatory compliance risk;
3.7 Conduct risk;
3.8 People and culture risk;
3.9 Business model risk; and
3.10 Model risk.

3.1 Credit risk

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

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

i. Counterparty risk: The risk of losses arising as a result of the counterparty not meeting their contractual obligations in full and on time;
ii. Credit default risk: The current or prospective risk to capital arising from the obligors' failure to meet the terms of any contract with the Bank; and
iii. Concentration risk: The risk of excessive credit concentration including to an individual, counterparty, group of connected counterparties, a type of collateral or a type of credit facility.

The most significant credit risks assumed by the Bank arise from mortgage lending activities to customers in the Republic of Ireland. Credit risk also arises on funds placed with other banks, derivatives relating to interest rate risk management and 'off-balance sheet' commitments.

Credit risk management

The activities which govern the management of credit risk within the Bank are as follows:

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

Credit risk management response to COVID-19

The Bank has adapted its credit risk management operating model, including its underlying credit processes, in response to COVID-19 to ensure proactive and appropriate management of the heightened credit risk in the mortgage portfolio. In adapting its credit operating model, the Bank have also enabled the introduction and implementation of a number of customer support measures in a streamlined, agile and risk appropriate manner.

The Bank's focus continues to be on supporting its existing customers and ensuring they are provided with the appropriate measures (e.g. payment breaks) taking account of the current and expected financial impact and recovery outlook. As part of the Bank's credit risk management response to COVID-19, a range of actions have been taken to ensure the appropriate measurement, classification, and reporting of its credit risk exposures during this time. These include:

– The development of a suite of additional guidance documents to support credit risk assessment and management activities, such as credit grading, staging, unlikely-to-pay testing, and taking account of COVID-19 sector risk and expected recovery outlook. This guidance supplements the Bank's existing credit risk policies and frameworks.
– Enhanced scope and frequency of mortgage portfolio asset quality monitoring as a result of COVID-19.

Bank Risk Appetite Statement

The Bank's RAS process defines the amount and types of risks that the Bank is willing to take, accept, or tolerate in pursuit of its business objectives and strategy as set by the Group Board. As part of the overall framework for risk governance, it forms a boundary condition to strategy and guides the Bank in its risk-taking and related business activities. Credit risk appetite is set at Group Board level and is described, reported and monitored through a suite of qualitative and quantitative metrics. Risk appetite is stress tested to ensure limits are within the risk-taking capacity of the Bank. The Bank's risk appetite for credit risk is reviewed and approved at least annually.

3.1 Credit risk

Credit risk principles and policy*

The Bank implements and operates policies to govern the identification, assessment, approval, monitoring and reporting of credit risk. The Bank relies on the Group credit risk framework and its supporting policies, processes and governance. The Group Credit Risk Framework and Group Credit Risk Policy are overarching Group Board approved documents which set out the principles of how the Group identifies, assesses, approves, monitors and reports credit risk to ensure robust credit risk management is in place. These documents contain the minimum standards and principles that are applied across the Group to provide a common, robust and consistent approach to the management of credit risk. The Group Credit Risk Policy is supported by a suite of credit policies, standards and guidelines which define in greater detail the minimum standards and credit risk metrics to be applied for specific products, business lines, and market segments.

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

Credit approval overview

The Bank operates credit approval criteria which:

– Include a clear indication of the Bank's target market(s), in line with its RAS;
– Require a thorough understanding and assessment of the borrower or counterparty, as well as the purpose and structure of credit, and the source of repayment; and
– Enforce compliance with minimum credit assessment standards and facility structuring standards.

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

Credit risk organisation and structure

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

Internal credit ratings*

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

Internal credit grading and scoring systems facilitate the early identification and management of any deterioration in loan quality. Changes in the objective information are reflected in the credit grade of the borrower with the resultant grade influencing the management of individual loans. In line with the Bank's credit management cycle, heightened credit management is in place and special attention is paid to lower quality performing loans or ‘criticised’ loans and non-performing/ defaulted loans which are defined below.

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

3.1 Credit risk
Internal credit ratings* (continued)
Strong/satisfactory
Accounts are considered strong/satisfactory if they have no current or recent credit distress and the PD is typically less than 6.95%, they are not in arrears and there are no indications that they are unlikely to repay.
Strong (typically with PD less than 0.99%): Strong credit with no weakness evident.
Satisfactory (typically with PD greater than or equal to 0.99% and less than 6.95%): Satisfactory credit with no weakness evident.

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

In addition to the internal credit ratings, the IFRS 9 PD modelling approach uses a combination of rating grades and scores obtained from these credit risk models along with key factors such as age of an account, the current/recent arrears status or the current/recent forbearance status and macroeconomic factors to obtain the relevant IFRS 9 12 month and Lifetime PDs (i.e. point in time). The Bank has set out its methodologies and judgements exercised in determining its ECL under IFRS 9 on pages 19 to 29.

Non-performing/default
The Bank's definition of default is aligned with the EBA 'Guidelines on the application of the definition of default' under Article 178 of Capital Requirements Regulation and ECB Banking Supervision Guidance to Banks on non-performing loans. Further enhancements were implemented in 2020 in compliance with Article 178(2)(d) of regulation (EU) no 575/2013 in relation to the approach to counting of material days past due. The Bank has aligned the definitions of 'non-performing', 'classification of default' and IFRS 9 Stage 3 'credit impaired', with the exception of those loans which have been derecognised and newly originated in Stage 1 or POCI (Purchased or Originated Credit Impaired). This alignment ensures consistency with the Bank's internal credit risk management and assessment practices.

Loans are identified as non-performing or defaulted by a number of characteristics. The key criteria resulting in a classification of non-performing are:
– Where the Bank considers a credit obligor to be unlikely to pay his/her credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount, or
– The credit obligor is 90 days or more past due on any material credit obligation. Day count starts when any material amount of principal, interest or fee has not been paid by a credit obligor on the due date; or
– The credit obligor was previously defaulted but remains forborne and is materially 30 days or more past due.

The Bank's definition of financial distress and forbearance are included in the Group's Forbearance policy. Identification and treatment of non-performing exposures and unlikeliness to pay are included in the Group's DoD and Credit Impairment policy.

Non-performing loans are analysed in more granular detail by the following categories on page 34.

Unlikely to pay – Where the Bank considers a credit obligor to be unlikely to pay his/her credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount.
Greater than 90 days past due – Credit obligor that is past due by 90 days or more on any material obligation.
Collateral disposals – Post restructure cases requiring asset disposal as part of the restructure agreement. These loans will remain as non-performing until the asset is sold and the loan cleared.
Non-performing loans probation – Where the credit obligor no longer has a default trigger, his / her credit obligations will remain in a non-performing probationary period, before moving to a performing classification, subject to meeting defined probation criteria.

3.1 Credit risk

Credit risk monitoring*

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

Credit risk, at a portfolio level, is monitored and reported regularly to senior management of the Bank and at Group Board Risk Committee. Credit managers proactively manage credit risk exposures at a transaction and relationship level. Monitoring includes credit exposure and excess management, regular review of accounts, being up to date with any developments in customer business, obtaining updated financial information and monitoring of covenant compliance. This is reported on a quarterly basis to senior management and includes commentary on loan book, quality of the loan book by Stage and expected credit loss P&L drivers.

The Bank allocates significant resources to ensure ongoing monitoring and compliance with approved risk limits. Credit risk, including compliance with key credit risk limits, is reported monthly. Once an account has been placed on a watch / early warning list, the exposure is carefully monitored and where appropriate, exposure reductions are effected. In addition, exceptions to credit policy are reviewed regularly.

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

Through a range of forbearance solutions, the Bank employs a dedicated approach to loan workout, monitoring and proactive management of non-performing loans. A specialised recovery function focuses on managing the majority of criticised loans and deals with customers in default, collection or insolvency. Their mandate is to support customers in difficulty while maximising the return on non-performing loans. Further details on forbearance are set out on page 39 and 40.

Credit exposure

Credit risk mitigants*

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

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

Collateral

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

The principal collateral types for loans and advances are Mortgage / legal charge over residential real estate

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

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

Methodologies for valuing collateral

Details on the methodologies applied and processes used to assess the value of property assets taken as collateral are described in the Group's Property Valuation Policy and Property Valuation Guidance. Due to the COVID-19 pandemic the Group has updated property valuation guidance policies to assist case managers in determining market values given current COVID-19 related market uncertainty.

3.1 Credit risk
Credit risk exposure (continued)
Methodologies for valuing collateral (continued)
For residential properties, a cautionary approach is applied to the use of comparable sales information in an area and indexation which may produce a skewed result as sales have slowed down.

As mortgage loans comprise of all of the Bank's loans and advances portfolio, some key principles have been applied in respect of the valuation of property collateral held by the Bank.

In accordance with the Group’s Property Valuation Policy and Guidelines, the Bank employs a number of methods to assist in reaching appropriate valuations for property collateral held. These include:
– Use of independent professional external valuations; and
– Use of internally developed methodologies, including residual valuations.

Use of independent professional external valuations represent circumstances where external firms are engaged to provide formal written valuations in respect of the property. Up to date external independent professional valuations are sought in accordance with the Group’s Property Valuation Policy and Guidelines. Available market indices for relevant assets, e.g. residential property are also used in valuation assessments, where appropriate.

When assessing the value of residential properties, recent transactional analysis of comparable sales in an area combined with the CSO Residential Property Price index in the Republic of Ireland may be used.

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

When undertaking an ECL review for individually assessed cases that have been deemed unlikely to pay, the present value of future cash flows, including the value of collateral held, and the likely time required to realise such collateral is estimated. An ECL allowance is raised for the difference between this present value and the carrying value of the loan.

The following tables show the estimated fair value of collateral held for the Bank's residential mortgages at 31 December 2020 and 2019:

					2020
	Measured at amortised cost				
	Stage 1 €m	Stage 2 €m	Stage 3 €m	POCI €m	Total €m
Fully collateralised[1]					
Loan-to-value ratio:					
Less than 50%	6,850	509	419	9	7,787
50% - 70%	4,512	338	206	18	5,074
71% - 80%	1,891	149	75	5	2,120
81% - 90%	1,776	115	49	2	1,942
91% - 100%	283	32	29	1	345
	15,312	1,143	778	35	17,268
Partially collateralised					
Collateral value relating to loans over 100% loan-to-value	56	22	61	1	140
Total collateral value	15,368	1,165	839	36	17,408
Gross carrying value residential mortgages	15,390	1,175	879	41	17,485
Loss allowance	(20)	(34)	(251)	(15)	(320)
Carrying value residential mortgages	15,370	1,141	628	26	17,165

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

3.1 Credit risk
Credit exposure
Collateral and ECLs (continued)

					2019
	Measured at amortised cost				
	Stage 1	Stage 2	Stage 3	POCI	Total
	€m	€m	€m	€m	€m
Fully collateralised(1)					
Loan-to-value ratio:					
Less than 50%	7,056	517	443	9	8,025
50% - 70%	4,650	350	233	18	5,251
71% - 80%	1,869	141	82	6	2,098
81% - 90%	1,523	103	57	3	1,686
91% - 100%	338	43	44	2	427
	15,436	1,154	859	38	17,487
Partially collateralised					
Collateral value relating to loans over 100% loan-to-value	79	33	70	1	183
Total collateral value	15,515	1,187	929	39	17,670
Gross carrying value residential mortgages	15,539	1,194	966	45	17,744
Loss allowance	(5)	(20)	(178)	(7)	(210)
Carrying value residential mortgages	15,534	1,174	788	38	17,534

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

For residential mortgages, the Bank takes collateral in support of lending transactions for the purchase of residential property. Collateral valuations are required at the time of origination of each residential mortgage. The value at 31 December 2020 and 2019 is estimated based on property values at origination or date of latest valuation and applying the CSO Residential Property Price Index to these values to take account of price movements in the interim.

Derivatives
Derivative financial instruments are recognised in the statement of financial position at their fair value. Those with a positive fair value are reported as assets which at 31 December 2020 amounted to €52m (2019: €64m) and those with a negative fair value are reported as liabilities which at 31 December 2020 amounted to nil (2019: €1m).

Loans and advances to banks
Interbank placings, including central banks, are largely carried out on an unsecured basis apart from reverse repurchase agreements. However, there were no repurchase agreements outstanding at 31 December 2020 (2019: nil).

3.1 Credit risk
Measurement, methodologies and judgements*
Introduction
The Bank has set out the methodologies used and judgements exercised in determining its ECL allowance for the year to 31 December 2020.

The Bank, in estimating its ECL allowances does so in line with the expected credit loss impairment model as set out by the International Financial Reporting Standard 9 Financial Instruments. This model requires a more timely recognition of ECL across the Group. The standard does not prescribe specific approaches to be used in estimating ECL allowances, but stresses that the approach must reflect the following:
– An unbiased and probability weighted amount that is determined by evaluating a range of possible outcomes;
– Underlying models should be point in time and forward looking – recognising economic conditions;
– The ECL must reflect the time value of money;
– A lifetime ECL is calculated for financial assets in Stage 2 and 3; and
– The ECL calculation must incorporate reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

The standard defines credit loss as the difference between all contractual cash flows that are due to an entity in accordance with the contract and all the cash flows that the entity expects to receive (i.e. all cash shortfalls), discounted at the original effective interest rate ('EIR') or an approximation thereof (see 'Measurement' section below).

ECLs are defined in the standard as the weighted average of credit losses across multiple macroeconomic scenarios, with weights assigned based on the probability of each scenario occurring and are an estimate of credit losses over the life of a financial instrument.

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

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

Bases of Measurement
Under the standard, there are two bases of measurement:
1. 12-month ECL (Stage 1), which applies to all financial instruments from initial recognition as long as there has been no significant increase in credit risk; and
2. Lifetime ECL (Stages 2 and 3 and POCI), which applies when a significant increase in credit risk has been identified on an account (Stage 2), an account has been identified as being credit-impaired (Stage 3) or when an account meets the (POCI) criteria.

Staging
Financial assets are allocated to stages dependent on credit quality relative to when assets were originated.

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

For undrawn credit facilities, the Bank uses the date of origination as the date when it becomes party to the irrevocably contractual arrangements or irrevocable commitment.

The Bank uses best available information for facilities which originated prior to credit risk rating model or scorecard being in place.

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

3.1 Credit risk

Measurement, methodologies and judgements* (continued)

Stage 1 characteristics

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

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

Stage 2 characteristics

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

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

SICR assessment

The Bank's SICR assessment is determined based on both quantitative and qualitative measures:

Quantitative measure: This measure reflects an arithmetic assessment of the change in credit risk arising from changes in the PD. The Bank compares each obligation's annualised average probability weighted residual lifetime probability of default ('LTPD') at origination (see the CRAO section) to its annualised average probability weighted residual LTPD at the reporting date. If the difference between these two LTPDs meets the quantitative definition of SICR, the Bank transfers the financial obligation into Stage 2. Increases in LTPD may be due to credit deterioration of the individual obligation or due to macroeconomic factors or a combination of both. The Bank has determined that an account had met the quantitative measure if the average residual LTPD at the reporting date was more than double the average residual LTPD at origination, and the difference between the LTPDs was at least 85bps. The appropriateness of this threshold is under regular review by the Bank.

Qualitative measure: This measure reflects the assessment of the change in credit risk based on the Bank's credit management and the individual characteristics of the financial asset. This is not model driven and seeks to capture any change in credit quality that may not be already captured by the quantitative criteria. The qualitative assessment reflects pro-active credit management including monitoring of account activity on an individual or portfolio level, knowledge of client behaviour, and cognisance of industry and economic trends. As a result of COVID-19 a suite of additional guidance documents to support identification of significant increase in credit risk have been applied by the Bank. This guidance supplements the Group's existing credit risk policies and frameworks.

The criteria for this trigger include, for example:

– A downgrade of the borrower's/facility's credit grade reflecting the increased credit management focus on these accounts; and/or
– Forbearance has been provided and the account is within the probationary period.

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

Where SICR criteria are no longer a trigger the account can exit Stage 2 and return to Stage 1.

Stage 3 characteristics

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

The key criteria resulting in a classification of default are:

– Where the Bank considers a credit obligor to be unlikely to pay his/her credit obligations in full without realisation of collateral, regardless of the existence of any past-due amount; or
– The credit obligor is 90 days or more past due on any material credit obligation (count starts when any amount of principal, interest or fee has not been paid by a credit obligor at the date it was due); or
– The credit obligor was previously defaulted but remains forborne and is materially 30 days or more past due.

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Stage 3 characteristics (continued)
The Bank's definition of financial distress and forbearance are included in the Group's Forbearance policy. Identification of non-performing exposures and unlikeliness to pay are included in the Group's DoD and Credit Impairment policy.

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

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

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

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

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

iii. Management judgement: Where the estimate of ECL does not adequately capture all available forward looking information about the range of possible outcomes or where there is a significant degree of uncertainty, management judgement may be considered appropriate for an adjustment to ECL. The management adjustment must consider all relevant and supportable information, including but not limited to, historical data analysis, predictive modelling and management experience. The methodology to incorporate the adjustment should consider the degree of over collateralization (headroom) and should not result in a zero overall ECL unless there is sufficient headroom to support this. The key judgements in the 2020 year end ECL estimates are outlined on pages 19 and 29.

Effective interest rate
The ECL must incorporate the time value of money discounted to the reporting date using the EIR determined at initial recognition or an approximation thereof.

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

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

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Policy elections and simplifications (continued)
Low credit risk exemption (continued)
Under IFRS 9 the credit risk on a financial instrument is considered low if:
- the financial instrument has a low risk of default;
- the borrower has a strong capacity to meet its contractual cash flow obligations in the near term; and
- adverse changes in economic business conditions in the longer term may (but will not necessarily), reduce the ability of the borrower to fulfil its contractual cash flow obligations.

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

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

Credit risk models
Probability of default
PD is the likelihood that an account or borrower defaults over an observation period, given that they are not currently in default. The PD modelling approach uses a combination of rating grades/scores obtained from credit risk models, as outlined on pages 14 and 15, along with key factors such as the current/recent arrears status or the current/recent forbearance status and macroeconomic factors to obtain the relevant 12 month (Stage 1) and Lifetime (Stage 2) PD.

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

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

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

Exposure at default
EAD is defined as the exposure amount that will be owed by a customer at the time of default. This will comprise changes in the exposure amount between the reporting date and the date that the customer defaults. This may be due to repayments, interest and fees charged and additional drawdowns by the customer.

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

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

Determining the period over which to measure ECL
Both the origination date and the expected maturity of a facility must be determined for ECL purposes. The origination date is used to measure credit risk at origination (as explained above). The expected maturity is used for assets in Stage 2, where the ECL must be estimated over the remaining life of the facility.

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

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

Write-offs
When the prospects of recovering a loan, either partially or fully, do not improve, a point will come when it will be concluded that as there is no realistic prospect of recovery, the loan and any related ECL will be written-off. The Bank determines, based on a specific criteria, the point at which, there is no reasonable expectation of recovery, e.g. inception of formal insolvency proceedings or receivership/other formal recovery action. This is considered on a case-by-case basis.

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

The contractual amount outstanding of loans written off during the year that are still subject to enforcement activity are outlined on page 39 and relate to non-contracted write-offs, both full and partial.

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

Macroeconomic scenarios and weightings
The macroeconomic scenarios used by the Bank for ECL allowance calculations are subject to AIB Group’s governance process covering the development and approval of macroeconomic scenarios for planning and stress testing. The macroeconomic scenarios and attached probabilities are reviewed by the Group's Asset and Liability Committee ('ALCo') regularly, and such reviews took place more frequently during 2020 in response to economic developments. The macroeconomic scenarios are also then reviewed by the Group Board Risk Committee ('BRC') and approved for use by the Group Board. The scenario probabilities are approved by the Group Board Audit Committee ('BAC'). The parameters used within the Group's ECL models include macroeconomic factors which are established as drivers of the default risk and loss estimates. Therefore, a different credit loss estimate is produced for each scenario based on a combination of these identified macroeconomic factors. The credit loss estimates for each given scenario are then weighted by the assessed likelihood of occurrence of the respective scenarios to yield the ECL outcome.

Macroeconomic scenarios:
The onset of the COVID-19 pandemic and associated lockdown measures and restrictions on economic activity means that the scenarios in use for year-end 2020 have changed materially from those applied for the year-end 2019 outcomes. In order to reflect the range of possible outcomes as well as the significant uncertainty presented by the public health crisis and associated economic downturn, as at the reporting date, four scenarios have been used in the ECL calculation. These four scenarios consist of a Base case scenario, along with three alternative scenarios (comprising one upside and two downside scenarios). The inclusion of an extra downside scenario (i.e. an extended high unemployment scenario) was deemed necessary to ensure that the range of possible outcomes in relation to the ultimate recovery from the pandemic are captured. Non-linear effects are captured in the development of risk parameters as well as through the inclusion of both the single upside and two downside scenarios.

The Group's Economic Research Unit provide the scenarios over five years. These are then independently reviewed and challenged, on both a quantitative and qualitative basis, by the Group Risk function. The Base case is benchmarked against the outlook available from official sources (e.g. ECB, Central Bank of Ireland, Department of Finance, ESRI, IMF, etc.) to ensure it is appropriate. Upside and downside scenarios, relative to the Base case, are provided to ensure a reasonable range of possible outcomes is available for the IFRS 9 process. These scenarios are benchmarked to alternative scenarios from official sources, where possible. The longer-term economic projections beyond five years are sourced from a reputable external provider with the internal scenarios converging on a linear basis towards the external forecasts from years 5 to 8. External long-term forecasts represent long-term base line forecasts for the parameter/ economy in question. The forecasted scenarios are kept under review on a quarterly basis by the Group ALCo and approved by the Group Board.

The scenarios used for the year-end process are described below and reflect the views of the Bank at the reporting date. A post-year-end adjustment has been applied due to the new public health restrictions announced in early January 2021. This is not reflected in the scenarios below – further detail can be found on pages 27 and 29.

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Macroeconomic scenarios: (continued)
Base case: The scenario assumes that further outbreaks of the virus occur in 2021 with associated public health containment measures but that the rate of infection declines over time reflecting advancements in treatments and better track and trace systems. It also assumes that a vaccine does not become widely available in 2021. The Base case assumptions are outlined on page 25.

GDP growth in most economies is expected to recover strongly in 2021 and 2022 following declines in 2020. Growth returns to longer term trends from 2023 and beyond. In this scenario, economic activity returns to pre-pandemic levels of activity by end-2021 in Ireland.

The rise in unemployment has been mitigated in most European economies by Government income support schemes. These support schemes have also resulted in increased uncertainty in relation to the true level of unemployment in economies. For Ireland, the approach is to estimate the true underlying rate (i.e. the rate after the temporary government support schemes have ended). This is between the official unemployment rate and the COVID-adjustment unemployment rate published by the CSO. In this scenario, unemployment remains relatively high over the coming years, remaining above the 2019 rate out to 2025.

House prices have been more robust than expected throughout 2020. This is due to a combination of effects, predominantly continued under-supply while reduced incomes as a result of public health restrictions haven't materially reduced demand. House prices are still expected to fall in 2021 in Ireland by c. 3%. This fall is much lower than would generally be associated with similar unemployment rates, demonstrating the unique impact of the virus on the economy.

This scenario incorporates the EU/UK trade deal that was implemented on the 1st January 2021. This mitigates many of the effects that would have been felt in the event of a no trade deal outcome. This scenario does reflect the increased non-tariff barriers that are in place as a result of the UK exiting the transition period on 31 December 2020.

Downside 1 ('Lower growth in 2021'): This scenario reflects a situation with limited recovery in terms of GDP growth in 2021 from the significant downturn during 2020. This is reflected through the virus being more severe than expected in 2021, resulting in extensive containment measures remaining in place for a longer period of time than assumed in the Base case. This holds back economic growth in 2021 and the additional scarring effects as a result of this results in growth being 3%-4% lower, versus the Base case, across the main economies over the 2021-2025 period. In this scenario, economic activity does not return to pre-pandemic levels of activity until mid-2022 in Ireland and 2025 in the UK.

Unemployment is higher in 2021 by c. 2 percentage points versus the Base case and remains higher than in the Base case over the period to 2025 as a result of the additional scarring.

The recovery in house prices is slower than the Base case, with growth in Ireland not seen until 2023 and house prices c. 5% lower in 2025 compared to the Base case.

Downside 2 ('Extended high unemployment'): This scenario reflects a situation where unemployment recovers very slowly and is still at 10% in Ireland in 2025. This is caused by very sluggish return to growth in major economies following a more persistent outbreak of the virus than expected in the Base case. This stops growth in 2021 and slows down the recovery significantly, with cumulative growth over 2021-2025 being c. 8% lower than in the Base case.

The implications for unemployment are very significant in this scenario, affecting sectors that have not been directly impacted from COVID due to scarring effects in the wider economy. Unemployment peaks at 13.5% in 2021 but only slowly reducing to 10% in 2025, 4 percentage points higher than the Base case.

House prices suffer large falls in 2021 to 2023 with prices only picking up slowly from 2024. Under this scenario, house prices are c. 24% lower in 2025 than under the Base case.

Upside ('Quick economic recovery'): This scenario reflects a much quicker economic recovery than outlined in the Base case. The key trigger for this are advances in therapeutic measures against the virus, including a rapid and successful roll out of a vaccine. While unemployment remains elevated relative to pre-COVID levels in the short term, by 2023 it has returned to less than 6%.

Under this scenario, house prices also return more quickly as demand continues to be robust. By 2025 house prices are c. 9% higher than in the Base case.

3.1 Credit risk

Measurement, methodologies and judgements* (continued)

Macroeconomic scenarios and weightings (continued)

The table below sets out the five year forecast for each of the key macroeconomic variables that are required to generate the scenarios or are material drivers of the ECL under (i) Base, (ii) Downside 1, (iii) Downside 2 and (iv) Upside scenarios at 31 December 2020, (average over 2021-2025) and at 31 December 2019 (average over 2020-2024).

	December 2020 5 year (2021-2025) average forecast				December 2019 5 year average forecast			
Macroeconomic factor (%)	**Base**	**Downside (‘Lower growth in 2021’)**	**Downside (‘Extended high un-employment**	**Upside (‘Quick economic recovery’)**	Base	Downside (‘disorderly’ Brexit)	Downside (‘global slowdown’)	Upside
GDP growth	**3.7**	**3.0**	**2.0**	**4.4**	2.9	1.8	1.7	4.1
Residential property price growth	**1.7**	**0.8**	**(3.6)**	**3.4**	2.6	0.2	0.5	4.6
Unemployment rate	**7.2**	**8.9**	**11.9**	**6.6**	4.7	7.8	7.4	4.0
Employment growth	**2.3**	**1.9**	**1.0**	**2.5**	1.7	0.6	0.6	2.5
Average disposable Income growth	**1.8**	**1.4**	**1.3**	**2.5**	3.7	1.5	1.5	5.0

Additional information provided in the table below details the individual macroeconomic factor forecast for each year across the four scenarios, as at 31 December 2020. Due to the increased variability as a result of COVID-19, the average for the five years 2021 - 2025 above does not provide additional insight for each factor across the impacted years.

	Estimate	**Base**					**Downside 1 ('Lower growth in 2021')**				
Macroeconomic factor	**2020 %**	**2021 %**	**2022 %**	**2023 %**	**2024 %**	**2025 %**	**2021 %**	**2022 %**	**2023 %**	**2024 %**	**2025 %**
GDP growth	**(3.0)**	**5.0**	**4.5**	**3.5**	**3.0**	**2.7**	**1.0**	**5.0**	**3.5**	**3.0**	**2.7**
Residential property price growth	**(1.5)**	**(3.0)**	**3.0**	**3.0**	**3.0**	**2.5**	**(7.0)**	**—**	**5.0**	**3.0**	**3.0**
Unemployment rate	**10.4**	**10.0**	**7.5**	**6.4**	**6.1**	**5.9**	**12.0**	**9.6**	**8.3**	**7.6**	**7.2**
Employment growth	**(5.0)**	**1.6**	**4.0**	**2.5**	**1.8**	**1.7**	**(1.0)**	**3.9**	**2.6**	**2.2**	**2.0**
Average disposable income growth	**7.1**	**(6.3)**	**6.9**	**0.5**	**5.6**	**2.5**	**(7.2)**	**5.8**	**0.7**	**4.7**	**2.9**

	Downside 2 ('Extended high unemployment')					**Upside 1 ('Quick economic recovery')**				
Macroeconomic factor	**2021 %**	**2022 %**	**2023 %**	**2024 %**	**2025 %**	**2021 %**	**2022 %**	**2023 %**	**2024 %**	**2025 %**
GDP growth	**(1.5)**	**3.0**	**2.8**	**2.8**	**3.0**	**7.0**	**5.5**	**4.0**	**3.0**	**2.7**
Residential property price growth	**(12.0)**	**(10.5)**	**(2.5)**	**4.0**	**3.0**	**3.0**	**5.0**	**3.0**	**3.0**	**3.0**
Unemployment rate	**13.5**	**13.0**	**12.0**	**11.0**	**10.0**	**9.5**	**7.2**	**5.8**	**5.4**	**5.1**
Employment growth	**(3.0)**	**1.7**	**2.1**	**2.1**	**2.2**	**2.1**	**3.9**	**2.8**	**2.0**	**1.8**
Average disposable Income growth	**(6.0)**	**5.5**	**0.2**	**4.8**	**1.8**	**(4.5)**	**5.2**	**4.0**	**3.8**	**4.0**

The key changes to the scenario forecasts in the reporting period are driven by the COVID-19 pandemic. The extent of contagion and wider economic impact of COVID-19 was not foreseen at the previous reporting period (31 December 2019). The severe and sudden shock to all economies has resulted in a significant re-assessment of the forecasts.

The four scenarios detailed above are used to reflect a representative sample of possible outcomes. The ECL allowance reflects a weighted average of the credit loss estimates under the four scenarios. Similar to the scenario forecasts, the probability weight assigned to each scenario is proposed by the ERU, with a review and challenge from the Group Risk function. These are reviewed regularly at Group ALCo and are subject to approval at Group Board Audit Committee. The probabilities described below reflect the views of the Bank at the reporting date.

3.1 Credit risk
Measurement, methodologies and judgements* (continued)
Macroeconomic scenarios and weightings (continued)
The weights for the scenarios are derived based on the expert judgement, with reference to external market information where possible. Given the unprecedented nature and impact of COVID-19, the standard quantitative approaches (such as statistical distribution analysis of Irish GDP growth over different time horizons informed by historic patterns in the economic data) used to assess scenario likelihoods are less useful than normal in this environment. As a result, they have not been a key driver of the weightings at the reporting date.

These weightings are reviewed regularly by Group ALCo and adjusted where required. The key drivers of the weightings at the reporting date are:

– The higher weighting on the downside scenarios (versus the upside scenario) reflects the view that risks remain skewed to the downside reflecting the continued inability of many countries to bring the virus under control, the potential for new mutations of the virus and the unknown medium- and longer-term economic impacts of the virus. Additionally other risks remain which also support this view that risks remain to the downside. These include the impacts of ongoing de-globalisation efforts, geopolitical risks and the timing of unwinding of central bank supports.

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

Scenario	**Weighting December 2020**		Weighting December 2019
Base	**50 %**	Base	50 %
Downside 1 'Lower growth in 2021'	**25 %**	Downside ('disorderly' Brexit)	25 %
Downside 2 'Extended high unemployment'	**5 %**	Downside ('global slowdown')	15 %
Upside 'Quick economic recovery'	**20 %**	Upside	10 %

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

Sensitivities
The Bank's estimates of expected credit losses are responsive to varying economic conditions and forward looking information. These estimates are driven by the relationship between historic experienced loss and the combination of macroeconomic variables. Given the co-relationship of each of the macroeconomic variables to one another and the fact that loss estimates do not follow a linear path, a sensitivity to any single economic variable is not meaningful. As such, the following sensitivities are provided which indicate the approximate impact on the current ECL allowance before the application of probability weights to the forward looking macroeconomic scenarios. The sensitivities provide an estimate of ECL movements driven by both changes in model parameters including current management judgements, and quantitative SICR staging assignments.

Relative to the base scenario, in the 100% downside 'lower growth in 2021' and 'extended high unemployment' scenario, the ECL allowance increases by 5% and 24% respectively. In the 100% upside scenario, the ECL allowance declines by 4%, showing that the ECL impact of the two downside scenarios is greater than that of the upside scenario. For 31 December 2020, a 100% downside 'lower growth in 2021' and 'extended high unemployment' scenarios sees a higher ECL allowance sensitivity of €17m and €75m respectively compared to base (€11m and €69m respectively compared to reported). This compares to an ECL allowance sensitivity, relative to the base scenario of €63m and €36m respectively compared to base, (€44m and €17m reported) for 31 December 2019.

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

	ECL allowance at 31 December 2020				
	Reported	100% Base	100% Downside Scenario ('Lower growth in 2021')	100% Downside Scenario ('Extended high unemployment')	100% Upside Scenario ('Quick economic recovery')
	Total	Total	Total	Total	Total
Loans and advances to customers	€m	€m	€m	€m	€m
Residential mortgages	320	314	331	389	303
Total	320	314	331	389	303
Off-balance sheet loan commitments	—	—	—	—	—
	320	314	331	389	303

	ECL allowance at 31 December 2019				
	Reported	100% Base	100% downside ('disorderly' Brexit)	100% downside ('global slowdown')	100% upside
	Total	Total	Total	Total	Total
Loans and advances to customers	€m	€m	€m	€m	€m
Residential mortgages	210	191	254	227	162
Total	210	191	254	227	162
Off-balance sheet loan commitments	—	—	—	—	—
Grand Total	210	191	254	227	162

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

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

The ECL allowance on loans and advances to customers at 31 December 2020 includes the following management adjustments:

1. Private dwelling house ('PDH') mortgage post model adjustments
The Bank's strategy is to deliver sustainable long term solutions and to work with customers through their financial difficulties. This has primarily been through work-out arrangements with customers, including arrears capitalisations, split mortgages, low fixed interest rate, voluntary sale for loss, negative equity trade down and positive equity solution or through loan recovery following realisation of collateral. The mortgage LGD model is based on empirical internal data for such resolved cases, and represents the Bank's expected loss based on those expected work-out strategies. However, it is recognised that alternative recovery strategies, such as portfolio sales or securitisations, also need to be considered which were not envisaged at the time of model development.

3.1 Credit risk

Measurement, methodologies and judgements* (continued)

1. Private dwelling house ('PDH') mortgage post model adjustments (continued)

Accordingly, a post model adjustment has been applied to a certain cohorts of Stage 3 loans to reflect the potential resolution outcomes not currently considered within the modelled outcome.

The post model adjustments are calculated based on a range of alternative recovery assumptions. An independent external benchmark exercise has been undertaken to provide information to support the range of alternative recovery outcomes with reference to collateral values underpinning the loans and the underlying market conditions.

Mortgage post model adjustment – long term days past due

The initial cohort of loans to which the post model adjustment applies continues to be primarily those PDH loans in Stage 3 in deep arrears i.e. greater than 180 days past due. The cohort has been extended in 2020 to include certain loans less than 180 days past due. The majority of this cohort is part of loan sales, which are expected to be executed in first quarter 2021.

The Mortgage ECL allowance of €320m for residential mortgages at 31 December 2020 includes €101m as a result of this management adjustment (31st December 2019: €210m and €62m respectively). The main drivers of movement in the post model adjustment to the 31st December 2020 are the impact of COVID-19 on the market outlook and the inclusion of certain loans less than 90 days past due. This has resulted in an additional income statement charge of €40m in 2020.

Mortgage post model adjustment – zero or low days past due non-performing exposures

Another cohort of loans to which a post model adjustment applies are also primarily PDH loans in Stage 3, displaying zero or low days past due and classified non-performing exposures under European Banking Authority definition of default guidelines. The main driver of this post model adjustment is the requirement for alternative recovery strategies for this cohort.

The ECL allowance for this cohort of residential mortgages in the Bank at 31st December 2020 includes €60m as a result of management adjustment. Management have considered the potential solutions available in determining the ECL allowance, which has resulted in a €50m income statement charge in 2020. This includes a cohort of forbearance product loans in Stage, 3 which were previously identified in 2019 as requiring an alternative treatment at loan expiry, which are now subsumed in this post model adjustment.

2. Lifetime interest only post model adjustment

A cohort of non-defaulted lifetime interest only mortgages were identified in 2019 for individual assessment to confirm likeliness to pay (31 December 2019: €44m). The loans within this cohort have been allocated to Stage 2, pending individual assessment, reflecting management's qualitative judgement of a significant increase in credit risk given the additional end of term risk not fully incorporated into modelled outcomes. This has resulted in a post model adjustment of €4m in 2020 (31 December 2019: €5m).

3. Covid-19 Modification Expiry post model adjustment

The performing Mortgage loans which had been granted COVID-19 short term modifications (e.g. payment breaks) during 2020 have been identified as requiring a temporary ECL post model adjustment due to the continued heightened risk of downward stage migration following the expiry of payment breaks.

The post model adjustment increases the ECL allowance on €619m of residential mortgages (Stage 1 €486m, Stage 2 €133m) which had received a COVID-19 modification during the course of 2020. It reflects the fact that following expiry of the temporary payment breaks, some of these borrowers will request or have received further support, e.g. forbearance, as these borrowers would otherwise be unable to return to their prior contractual loan repayments. The ECL post model adjustment allows for early recognition of anticipated downward stage migrations and unlikeliness to pay outcomes following expiry of the temporary COVID-19 modifications, which are not currently reflected within the customers' credit grade or the probability of default assigned within the ECL model.

The post model adjustment amounts to a €8m income statement charge for the full year 2020 as informed by business management judgment on anticipated flows to forbearance and/or default following the payment break expiry, with due consideration for continued impacts of COVID-19 at year end and as we move into 2021. The post model adjustment is temporary in nature and will be unwound in 2021 in line with the customer engagement and credit assessment process.

A similar situation to that outlined above exists in relation to another cohort of mortgage loans (€25 million) connected to SME borrowers subject to a COVID-19 modification in the Group's Corporate, Institutional & Business Banking portfolio. This post model adjustment amounts to a €3m income statement charge for the full year 2020.

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

4. Macroeconomic post model adjustment
The Group has identified that a post model adjustment is required for its base case macroeconomic scenario projections for 2021. Due to the increased spread of the COVID-19 virus, the Irish Government announced further lockdown requirements which came into effect in early January 2021. The extent of the restrictions have been much greater than those expected in the macroeconomic estimations however the efficacy and early roll out of vaccines as compared with the Bank's base case provides an offset in terms of medium term outlook.

A quantitative and qualitative assessment has been carried out to review the adequacy of ECL allowance given the delay in economic recovery caused by these increased restrictions. From a quantitative perspective the Bank has assessed that the restrictions could reduce its 2021 growth projections in Ireland by c. 2% and increase its projections of Irish unemployment by c. 0.7% for 2021. These short term impacts are assessed to reverse over the medium term due to the improved vaccine outlook.

A quantitative assessment using model data and a qualitative review by credit portfolio management teams have identified the requirement for a €2m post model adjustment to capture the combined impact of these changes in outlook.

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

The key governance points in the ECL approval process during 2020 were:
– Model Risk Committee;
– Asset and Liability Committee;
– Business level ECL Committees;
– Group Credit Committee; and
– Board Audit Committee.

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

Assessment of the credit quality of the Bank and each business segment is initially informed by the output of the quantitative analytical models but may be subject to management adjustments. The Bank and each business segment ECL output is then subject to approval at individual business unit level (ECL Committee) prior to onward submission to the Group Credit Committee (GCC). GCC reviews and challenges ECL levels for onward recommendation to the Board Audit Committee as the final approval authority.

Credit exposure overview
Maximum exposure to credit risk*
Maximum exposure to credit risk from on-balance sheet and off-balance sheet financial instruments is presented before taking account of any collateral held or other credit enhancements (unless such enhancements meet accounting offsetting requirements). For financial assets recognised on the statement of financial position, the maximum exposure to credit risk is their carrying amount, and for financial guarantees and similar contracts granted, it is the maximum amount the Bank would have to pay if the guarantees were called upon. For loan commitments and other credit related commitments that are irrevocable over the life of the respective facilities, it is generally the full amount of the committed facilities.

3.1 Credit risk

Credit exposure overview (continued)

Maximum exposure to credit risk*

The following table sets out the maximum exposure to credit risk that arises within the Bank and distinguishes between those assets that are carried in the statement of financial position at amortised cost and those carried at fair value at 31 December 2020 and 2019:

			2020			2019
Maximum exposure to credit risk	**Amortised cost[(1)]**	**Fair value[(2)]**	**Total**	Amortised cost[(1)]	Fair value[(2)]	Total
	€m	**€m**	**€m**	€m	€m	€m
Derivative financial instruments	**—**	**52**	**52**	—	64	64
Loans and advances to banks	**70**	**—**	**70**	85	—	85
Loans and advances to customers	**17,165**	**—**	**17,165**	17,534	—	17,534
Included elsewhere:						
Accrued interest	**29**	**—**	**29**	30	—	30
Other assets	**—**	**—**	**—**	83	—	83
	17,264	**52**	**17,316**	17,732	64	17,796
Off balance sheet loan commitments[(3)]	**559**	**—**	**559**	595	—	595
Maximum exposure to credit risk	**17,823**	**52**	**17,875**	18,327	64	18,391

[(1)]All amortised cost items are loans and advances which are in a 'held-to-collect' business model.

[(2)]All items measured at fair value except investment securities at FVOCI and cash flow hedging derivatives are classified as 'fair value through profit or loss'.

[(3)]A commitment is an off-balance sheet product, where there is an agreement to provide an undrawn credit facility. The contract may or may not be cancelled unconditionally at any time without notice depending on the terms of the contract.

3.1 Credit risk

Credit exposure overview (continued)

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

The following table summarises financial instruments in the statement of financial position at 31 December 2020 and 2019:

	2020				2019			
			Statement of financial position	**Income statement**			Statement of financial position	Income statement
	Exposure	**ECL allowance**	**Carrying amount**	**Net credit impairment (charge)**	Exposure	ECL allowance	Carrying amount	Net credit impairment writeback
	€m	**€m**	**€m**	**€m**	€m	€m	€m	€m
Loans and advances to banks	**70**	**—**	**70**	**—**	85	—	85	—
Loans and advances to customers:	**17,485**	**(320)**	**17,165**	**(113)**	17,744	(210)	17,534	3
Off balance sheet loan commitments	**559**	**—**	**559**	**—**	595	—	595	—
Total				**(113)**				3

There was a €113m net credit impairment charge in the year to 31 December 2020 (2019: credit impairment writeback of €3m). This comprised of a €113m charge on loans and advances to customers (net re-measurement of ECL allowance charge of €128m (2019: gross charge of €16m), offset by recoveries of amounts previously written-off of €15m (2019 €19m):) and a nil writeback for off-balance sheet exposures (2019: nil).

Further details on the net credit impairment charge in the 12 months to 31 December 2020 are set out on page 84.

3.1 Credit risk - Credit profile of the loan portfolio

The following table analyses the residential mortgage portfolio by ECL staging at 31 December 2020 and 2019:

Amortised cost			**2020**			2019
	Owner-Occupier	**Buy-To-Let**	**Total**	Owner-Occupier	Buy-To-Let	Total
Gross loans and advances to customers	**€m**	**€m**	**€m**	€m	€m	€m
Total gross carrying amount	**15,725**	**1,760**	**17,485**	15,728	2,016	17,744
Analysed as to ECL staging						
Stage 1	**14,058**	**1,332**	**15,390**	13,994	1,545	15,539
Stage 2	**943**	**232**	**1,175**	941	253	1,194
Stage 3	**687**	**192**	**879**	752	214	966
POCI	**37**	**4**	**41**	41	4	45
Total	**15,725**	**1,760**	**17,485**	15,728	2,016	17,744
ECL allowance - statement of financial position						
Stage 1	**(15)**	**(5)**	**(20)**	(4)	(1)	(5)
Stage 2	**(19)**	**(15)**	**(34)**	(10)	(10)	(20)
Stage 3	**(200)**	**(51)**	**(251)**	(139)	(39)	(178)
POCI	**(13)**	**(2)**	**(15)**	(4)	(3)	(7)
Total ECL allowance	**(247)**	**(73)**	**(320)**	(157)	(53)	(210)
Total carrying value of residential mortgages	**15,478**	**1,687**	**17,165**	15,571	1,963	17,534
ECL allowance cover percentage	**%**	**%**	**%**	%	%	%
Stage 1	**—**	**—**	**—**	—	—	—
Stage 2	**2**	**6**	**3**	1	4	2
Stage 3	**29**	**27**	**29**	18	18	18
POCI	**35**	**50**	**37**	10	75	16
Income statement						
Net remeasurement of ECL allowance	**104**	**24**	**128**	22	(6)	16
Recoveries of amounts previously written-off	**(11)**	**(4)**	**(15)**	(12)	(7)	(19)
Net credit impairment charge/ (writeback)	**93**	**20**	**113**	10	(13)	(3)
	%	**%**	**%**	%	%	%
Net credit impairment charge/ (writeback) on average loans	**0.59**	**1.06**	**0.64**	0.06	(0.54)	(0.02)

Gross loans and advances to customers

Gross loans and advances to customers reduced by €259m in the year to 2020. The reduction was driven by repayments net of interest credited and other miscellaneous movements of €1,814m. These reductions were offset against new lending activity of €1,555m in 2020 which was €349m lower than 2019.

Stage 3 loans decreased by €87m to €879m. The reduction was as a result of repayments net of interest credited of €112m and write-offs of €17m. These reductions were offset by net stage transfers to Stage 3 of €18m and other movements of €24m.

ECL allowance

The ECL allowance on loans and advances to customers increased by €110m to €320m in the 12 months to 31 December 2020. The increase was predominately due to post model adjustments and changes to the macroeconomic scenarios as a result of COVID-19. The ECL cover rate has increased from 1.2% at 31 December 2019 to 1.8% at 31 December 2020.

3.1 Credit risk - Credit profile of the loan portfolio (continued)

Internal credit grade profile by ECL staging

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

					2020
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
Amortised cost	**€m**	**€m**	**€m**	**€m**	**€m**
Strong	**13,899**	**254**	**—**	**2**	**14,155**
Satisfactory	**1,338**	**465**	**—**	**1**	**1,804**
Total strong/satisfactory	**15,237**	**719**	**—**	**3**	**15,959**
Criticised watch	**148**	**226**	**—**	**1**	**375**
Criticised recovery	**2**	**230**	**—**	**—**	**232**
Total criticised	**150**	**456**	**—**	**1**	**607**
Non-performing	**3**	**—**	**879**	**37**	**919**
Gross carrying amount	**15,390**	**1,175**	**879**	**41**	**17,485**
ECL allowance	**(20)**	**(34)**	**(251)**	**(15)**	**(320)**
Carrying amount	**15,370**	**1,141**	**628**	**26**	**17,165**

					2019
	Stage 1	Stage 2	Stage 3	POCI	Total
Amortised cost	€m	€m	€m	€m	€m
Strong	14,045	89	—	1	14,135
Satisfactory	1,346	485	—	—	1,831
Total strong/satisfactory	15,391	574	—	1	15,966
Criticised watch	144	254	—	1	399
Criticised recovery	1	366	—	2	369
Total criticised	145	620	0	3	768
Non-performing	3	—	966	41	1,010
Gross carrying amount	15,539	1,194	966	45	17,744
ECL allowance	(5)	(20)	(178)	(7)	(210)
Carrying amount	15,534	1,174	788	38	17,534

Of the total loans to customers of €17,485m, €15,959m or 91% are rated as either 'strong' or 'satisfactory' which is a decrease of €7m (2019: €15,966m or 90%). Stage 2 'strong' classification increased from €89m to €254m due to a reduction in credit quality. The 'criticised' classification includes 'criticised watch' of €375m and 'criticised recovery' of €232m, the total of which has decreased by €161m in the year to 31 December 2020. Overall, the total performing book has decreased by €168m to €16,566m or 95% of gross loans and advances to customers (2019: €16,734m and 94%).

3.1 Credit risk

Non-performing exposures ('NPE') to customers

Non-performing loans are aligned to the Bank's DoD and Stage 3 credit impaired with the exception of those originating in Stage 1 (€3m) and POCI (€37m). Non-performing loans have reduced by €91m to €919m or 5% of gross loans and advances to customers (2019: €1,010m and 6%). This reduction reflects repayments exceeding net flows to non-performing during the year.

The table below further analyses non-performing loans and advances to customers by asset class at 31 December 2020 and 2019:

	2020	2019
Non-performing loans	**Total**	Total
Residential Mortgages	**€m**	€m
At amortised cost		
Collateral disposals	**44**	58
Unlikely to pay (including > 90 days past due)	**769**	833
Non-performing loans probation	**106**	119
Total non-performing loans and advances to customers	**919**	1,010
Total ECL on non-performing loans and advances to customers	**266**	185
Non-performing loans as % of total loans and advances to customers	**5%**	6%

Income statement

There was a €113m net credit impairment charge in the year to 31 December 2020, net re-measurement of ECL allowance charge of €128m recoveries offset by recoveries of amounts previously written-off of €15m.

There were two key drivers contributing to the €128m gross charge, both of which were impacted by COVID-19. Post model adjustments as outlined under the Management Judgements section accounted for €103m, primarily comprising of €40m and €50m for the mortgage PDH long term arrears and zero arrears respectively and a further €11m for the Covid-19 expiry modification. Changes to the macroeconomic scenarios and probability weightings accounted for a €44m charge.

Net re-measurement within stage resulted in a charge of €27m, however this was partially offset by a €7m writeback as a result of net stage migration within stage. The ECL allowance movements are outlined on page 38.

Recoveries of amounts previously written-off amounted to €15m in 2020 (2019: €19m).

Residential mortgage arrears

Total loans in arrears (including non-performing loans) by value decreased by 13% during the year to 31 December 2020, a decrease of 13% in the owner-occupier portfolio and a decrease of 11% in the buy-to-let portfolio. The decrease in the buy-to-let arrears was driven by the portfolio sale of distressed loans.

3.1 Credit risk

Loans and advances to customers - Residential mortgages

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

The following table profiles the residential mortgage portfolio by the indexed loan-to-value ('LTV') ratios and the weighted average loan-to-value ratios at 31 December 2020 and 2019:

					2020					2019
	At amortised cost					At amortised cost				
	Stage 1	Stage 2	Stage 3	POCI	Overall total	Stage 1	Stage 2	Stage 3	POCI	Overall total
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Less than 80%	13,253	996	699	33	14,982	13,572	1,005	765	34	15,376
81 - 100%	2,059	147	78	3	2,287	1,860	145	101	5	2,111
100 - 120%	39	15	36	—	90	58	24	40	1	123
Greater than 120%	31	16	41	1	89	41	18	51	—	110
Total with LTVs	**15,382**	**1,174**	**854**	**37**	**17,448**	15,531	1,192	957	40	17,720
Unsecured	8	1	25	4	37	8	2	9	5	24
Total	**15,390**	**1,175**	**879**	**41**	**17,485**	15,539	1,194	966	45	17,744
Of which:										
Owner occupier										
Less than 80%	12,006	802	562	32	13,402	12,139	804	614	33	13,590
81 - 100%	2,002	127	57	3	2,189	1,789	117	73	5	1,984
100 - 120%	27	8	26	—	61	40	14	28	1	83
Greater than 120%	18	5	26	1	50	22	5	35	—	62
Total with LTVs	**14,053**	**942**	**671**	**36**	**15,702**	13,990	940	750	39	15,719
Unsecured	5	1	16	2	24	4	1	2	2	9
Total	**14058**	**943**	**687**	**38**	**15726**	13,994	941	752	41	15,728

The weighted average indexed loan-to-value of the stock of residential mortgages at 31 December 2020 was 55%, new residential mortgages issued during the year was 69% and Stage 3 residential mortgages was 57%.

The weighted average indexed loan-to-value of the stock of residential mortgages at 31 December 2019 was 54%, new residential mortgages issued during the year was 68% and Stage 3 residential mortgages was 56%.

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

Residential mortgages – properties in possession

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

The number (stock) of properties in possession at 31 December 2020 and 2019 is set out below:

	2020		2019	
	Stock	**Balance outstanding €m**	Stock	Balance outstanding €m
Owner-Occupier	**100**	**19**	116	23
Buy-To-Let	**12**	**2**	19	4
Total	**112**	**21**	135	27

The stock of residential properties in possession decreased by 23 properties in 2020 (2019: decreased by 29 properties). This decrease relates to the disposal of 27 properties (2019: 48 properties) which were offset by the addition of 12 properties (2019: 36 properties), the majority of which were voluntary surrenders or abandonments. In addition, a further 8 properties were removed from the stock in 2020 (2019: 17 properties), mainly due to the sale of a portfolio of loans.

The disposal of 27 residential properties in the Republic of Ireland resulted in a total profit on disposal of €1m at 31 December 2020 (before loss allowance) and compares to 31 December 2019 when 48 residential properties were disposed of resulting in a total loss of €7m. COVID-19 impacted the closing of sales in 2020. Losses on the sale of such properties are recognised in the income statement as part of the net credit impairment losses.

Residential mortgages – repossessions disposed of

The following table analyses the disposals of repossessed properties for the years ended 31 December 2020 and 2019:

					2020
	Number of disposals	**Outstanding balance at repossession date €m**	**Gross sales proceeds on disposal €m**	**Costs to sell €m**	**Profit on sale[(1)] €m**
Owner-Occupier	**24**	**5**	**6**	**—**	**(1)**
Buy-To-Let	**3**	**1**	**1**	**—**	**—**
Total residential	**27**	**6**	**7**	**—**	**(1)**

					2019
	Number of disposals	Outstanding balance at repossession date €m	Gross sales proceeds on disposal €m	Costs to sell €m	Loss on sale[(1)] €m
Owner-Occupier	45	10	4	—	7
Buy-To-Let	3	1	—	—	—
Total residential	48	11	4	—	7

(1) Before ECL allowance

3.1 Credit risk- Credit profile of the loan portfolio - Asset class analysis
Gross loans movements and ECL movements

The following table set out the movements in the gross carrying amount and ECL allowances for loans and advances to customers by ECL for the years to 31 December 2020 and 2019.

Amounts that triggered movements between Stage 1 and Stage 2 as a result of failing/curing a quantitative measure only (as disclosed on page 20) and that subsequently reverted within the period to their original stage, are excluded from 'Transferred from Stage 1 to Stage 2' and 'Transferred from Stage 2 to Stage 1'. The Bank believes this presentation aids the understanding of underlying credit migration.

Gross carrying amount movements

					2020
	Stage 1	**Stage 2**	**Stage 3**	**POCI**	**Total**
	€m	**€m**	**€m**	**€m**	**€m**
At 1 January	**15,539**	**1,194**	**966**	**45**	**17,744**
Transferred from Stage 1 to Stage 2	**(980)**	**980**	**—**	**—**	**—**
Transferred from Stage 2 to Stage 1	**837**	**(837)**	**—**	**—**	**—**
Transferred to Stage 3	**(18)**	**(103)**	**121**	**—**	**—**
Transferred from Stage 3	**9**	**94**	**(103)**	**—**	**—**
New loans originated/top-ups	**1,586**	**—**	**—**	**—**	**1,586**
Redemptions/repayments	**(1,969)**	**(166)**	**(126)**	**(6)**	**(2,267)**
Interest credited	**370**	**27**	**14**	**2**	**413**
Write-offs	**—**	**—**	**(17)**	**(1)**	**(18)**
Other movements	**16**	**(14)**	**24**	**1**	**27**
At 31 December	**15,390**	**1,175**	**879**	**41**	**17,485**

					2019
	Stage 1	Stage 2	Stage 3	POCI	Total
	€m	€m	€m	€m	€m
At 1 January	14,348	2,265	1,524	64	18,201
Transferred from Stage 1 to Stage 2	(603)	603	—	—	—
Transferred from Stage 2 to Stage 1	1,107	(1,107)	—	—	—
Transferred to Stage 3	(26)	(113)	139	—	—
Transferred from Stage 3	7	133	(140)	—	—
New loans originated/top-ups	1,934	—	—	2	1,936
Redemptions/repayments	(1,960)	(259)	(183)	(6)	(2,408)
Interest credited	357	44	11	3	415
Write-offs	—	—	(49)	(2)	(51)
Derecognised due to disposals	(16)	(20)	(334)	(1)	(371)
Other movements	391	(352)	(2)	(15)	22
At 31 December	15,539	1,194	966	45	17,744

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

3.1 Credit risk- Credit profile of the loan portfolio - Asset class analysis
Gross loans movements and ECL movements
ECL allowance movements

	Stage 1	Stage 2	Stage 3	POCI	2020 Total
	€m	€m	€m	€m	€m
At 1 January	**5**	**20**	**178**	**7**	**210**
Transferred from Stage 1 to Stage 2	**(7)**	**17**	**—**	**—**	**10**
Transferred from Stage 2 to Stage 1	**10**	**(17)**	**—**	**—**	**(7)**
Transferred to Stage 3	**—**	**(7)**	**17**	**—**	**10**
Transferred from Stage 3	**2**	**5**	**(13)**	**—**	**(6)**
Net Remeasurement	**(8)**	**(10)**	**(10)**	**1**	**(27)**
New loans originated/top-ups	**3**	**—**	**—**	**—**	**3**
Redemptions/repayments	**(1)**	**(1)**	**—**	**—**	**(2)**
Impact of model and overlay changes	**2**	**12**	**81**	**8**	**103**
Impact of credit or economic risk parameters	**14**	**15**	**15**	**—**	**44**
Income statement net credit impairment charge for the period	**15**	**14**	**90**	**9**	**128**
Write-offs	**—**	**—**	**(17)**	**(1)**	**(18)**
Other movements	—	—	—	—	—
At 31 December 2020	**20**	**34**	**251**	**15**	**320**

	Stage 1	Stage 2	Stage 3	POCI	2019 Total
	€m	€m	€m	€m	€m
At 1 January	4	21	279	10	314
Transferred from Stage 1 to Stage 2	(1)	12	—	—	11
Transferred from Stage 2 to Stage 1	2	(10)	—	—	(8)
Transferred to Stage 3	—	(3)	12	—	9
Transferred from Stage 3	—	5	(13)	—	(8)
Net remeasurement	1	(12)	7	(2)	(6)
New loans originated/top-ups	1	—	—	—	1
Redemptions/repayments	—	(1)	—	—	(1)
Impact of model and overlay changes	(2)	5	3	—	6
Impact of credit or economic risk parameters	—	3	8	1	12
Income statement net credit impairment charge/ (writeback)	1	(1)	17	(1)	16
Write-offs	—	—	(49)	(2)	(51)
Derecognised due to disposals	—	—	(69)	—	(69)
Exchange translation adjustments	—	—	—	—	—
At 31 December 2019	5	20	178	7	210

Total exposures to which an ECL applies decreased during the period by €259m from €17,744m as at 1 January 2020 to €17,485m as at 31 December 2020.

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

The gross loan transfers from Stage 1 to Stage 2 of €980m are due to underlying credit management activity where a significant increase in credit risk occurred at some point during the year through either the quantitative or qualitative criteria for stage movement and incorporates loans which transferred due to the impact of the updated macroeconomic forecasts. The main driver of the total movements to Stage 2 was the doubling of PDs, subject to 85bps.

3.1 Credit risk- Credit profile of the loan portfolio - Asset class analysis
Gross loans movements and ECL movements
Similarly, transfers from Stage 2 to Stage 1 of €837m represent those loans where the triggers for significant increase in credit risk no longer apply or loans that have fulfilled a probation period. These transfers include loans which have been upgraded through normal credit management process.

Transfers from Stage 2 to Stage 3 of €103m represent those loans that defaulted during the year. These arose in cases where it was determined that the customers were unlikely to pay their credit obligations in full without the realisation of collateral regardless of the existence of any past due amount or the number of days past due. In addition, transfers also include all credit obligors that are 90 days or more past due on a material obligation.

Transfers from Stage 3 to Stage 2 of €94m were mainly driven by resolution activity with the customer, through either restructuring or forbearance previously granted and which subsequently adhered to default probation requirements. As part of the credit management practices, active monitoring of loans and their adherence to default probation requirements is in place. Transfers from Stage 3 to Stage 1 of €9m primarily reflect curing events from default where no forbearance measure was required.

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

The contractual amount outstanding of loans written-off during the year that are subject to enforcement activity amounted to €8m (2019: €36m) which includes both full and partial write-offs. Total cumulative non-contracted loans written-off at 31 December 2020 amounted to €295m (2019: €310m).

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

Stage 1 loans decreased by €149m in 2020 with an ECL of €20m and resulting cover of 0.13%. This was primarily on foot of a reduction in net new lending.

Stage 2 loans decreased by €19m in 2020 with an ECL of €34m and resulting cover of 2.89%. This was driven by loans for which a significant increase in credit risk no longer applied and/or which had completed a probation period.

Stage 3 loans decreased by €87m in 2020 with an ECL of €251m and resulting cover of 28.56%.The Key drivers were repayments and redemptions and loans completing default probation periods.

Forbearance*
Forbearance occurs when a customer is granted a temporary or permanent concession or an agreed change to the existing contracted terms of a facility (‘forbearance measure’), for reasons relating to the actual or apparent financial stress or distress of that customer. This also includes a total or partial refinancing of existing debt due to a customer availing of an embedded forbearance clause(s) in their contract. A forbearance agreement is entered into where the customer is in financial difficulty to the extent that they are unable to meet their credit obligations to the Bank in compliance with the existing agreed contracted terms and conditions. A concession or an agreed change to the contracted terms can be of a temporary (e.g. interest only) or permanent (e.g. term extension) nature.

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

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

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

3.1 Credit risk

Forbearance* (continued)

The effectiveness of forbearance measures over the lifetime of the arrangements are subject to ongoing management review and monitoring of forbearance. A forbearance measure is deemed to be effective if the customer meets the revised or original terms of the contract over a sustained period of time resulting in an improved outcome for the Bank and the customer.

Irish residential mortgages subject to forbearance measures decreased by €231m from €1.2bn at 31 December 2019 to €985m at 31 December 2020, compared to a decrease of €800 million in the 12 months to 31 December 2019. Payment break options introduced specifically to support customers in response to COVID-19 and which met the definition of general payment moratoria as outlined in the relevant EBA Guidelines are not reported as forbearance measures.

Mortgage Portfolio

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

The four step process is summarised as follows:

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

The core objective of the process is to determine sustainable solutions that, where possible, help to keep customers in their family home. In addition to relevant short term measures (such as interest only and capital and interest moratorium), this includes long term forbearance measures which have been devised to assist existing Republic of Ireland primary residential mortgage customers in financial difficulty. This process may result in debt write-off, where appropriate. The types of existing long term forbearance solutions currently include; arrears capitalisation, term extension, low fixed interest rate sustainable solution, split mortgages, negative equity trade down and voluntary sale for loss.

3.1 Credit risk - Credit quality of forborne loans and advances to customers
The following table sets out the internal credit ratings and ECL staging of forborne loans and advances to customers at 31 December 2020 and 2019:

At amortised cost	2020 Total €m	2019 Total €m
Analysed by forbearance type		
Temporary forbearance	**519**	496
Permanent forbearance	**467**	720
Total	**985**	1,216
Analysed by internal credit ratings		
Strong	**—**	—
Satisfactory	**—**	—
Total strong/satisfactory	**—**	—
Criticised watch	**—**	—
Criticised recovery	**232**	379
Total criticised	**232**	379
Non-performing	**753**	837
Gross carrying amount	**985**	1,216
Analysed by ECL staging		
Stage 1	**4**	13
Stage 2	**230**	366
Stage 3	**714**	794
POCI	**37**	43
Total	**985**	1,216
Total gross carrying amount of loans and advances to customers	**17,485**	17,744

3.2 Funding and liquidity risk

Liquidity risk is the risk that the Bank will not be able to fund its assets and meet its payment obligations as they fall due, without incurring unacceptable costs or losses. Liquidity risk arises from differences in timing between cash inflows and outflows and can increase due to the unexpected lengthening of maturities or non-repayment of assets, a sudden withdrawal of deposits or the inability to refinance maturing debt.

Funding is the means by which liquidity is generated, e.g. secured or unsecured, wholesale, corporate or retail. In this respect, funding risk is the risk that a specific form of liquidity cannot be obtained at an acceptable cost. Funding risk can occur where there is an over-reliance on a particular type of funding, a funding gap or a concentration of wholesale funding maturities.

The objective of liquidity management is to ensure that, at all times, the Bank holds sufficient funds to meet its contracted and contingent commitments to customers and counterparties at an economic price.

The Bank's liquidity risk is managed as part of the overall Group liquidity management. In accordance with the Capital Requirements Regulation ('CRR'), the Bank has appointed the Group as its liquidity manager to fulfil daily cash flow management, oversee any changes required in liquidity management or reporting and manage the Bank's liquidity risk as part of the Group liquidity risk management process. This includes the risk identification and assessment, risk management and mitigation, risk monitoring and reporting processes. Under this centralised approach the management of liquidity and related activities for the Bank is integrated with the Group.

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

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

I. the issuance of Mortgage Covered Securities in accordance with the Asset Covered Securities Acts ('ACS Acts');
II. borrowing funds from AIB;
III. 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; and
IV. capital funding to ensure at a minimum compliance with the capital adequacy requirements of the Single Supervisory Mechanism ('SSM').

If utilised, the MBPN Facility would be secured by a floating charge over a pool of the Bank's home loans and related security which would be separate to the Pool (that secures the Mortgage Covered Securities) maintained by the Issuer in accordance with the ACS Acts. The Bank's Management team monitors the funding and liquidity risks and reports to the Board on developments on a regular basis.

Identification and assessment

Funding and liquidity risk is identified and assessed using a range of Liquidity Stress Testing scenarios and ensuring adherence to limits based on both internal limits and regulatory defined liquidity ratios, the Liquidity Coverage Ratio ('LCR') and the Net Stable Funding Ratio ('NSFR'). Liquidity stress testing consists of applying severe but plausible stresses to the Group's liquidity buffer through time in order to simulate a survival period. The LCR is designed to promote short term resilience of a bank's liquidity risk profile by ensuring that it has sufficient high quality liquid resources to survive an acute stress scenario lasting for 30 days. The NSFR has a time horizon of one year and has been developed to promote a sustainable maturity structure of assets and liabilities. These metrics are key risk metrics for the Group and are monitored against Group Board approved limits.

Management and measurement*

The Internal Liquidity Adequacy Assessment Processes('ILAAP') is fully integrated and embedded in the strategic, financial and risk management processes of the Group. An ILAAP Framework and supporting policies are in place which sets out the key processes, governance arrangements and roles and responsibilities which support the ILAAP. The Bank's Board adopts applicable group policies as appropriate. Embedding of the ILAAP is facilitated through liquidity and funding planning, the setting of risk appetite and risk adjusted performance monitoring. In addition to the Group's Funding and Liquidity Plan, a Contingency Funding Plan is in place which identifies and quantifies actions which are available to the Group in order to mitigate against the impact of a stress event. Trigger points at which these actions will be considered are also identified. A further set of triggers and liquidity options are set out in the Group's recovery plan, which presents the actions available to the Group to restore viability in the event of extreme stress. Finally, the Group has an approved liquidity cost-benefit allocation mechanism in place by which funding costs, benefits and risks are reflected in the Bank's business lines.

* Forms an integral part of the audited financial statements

3.2 Funding and liquidity risk (continued)

2020 developments in response to COVID-19

Precautionary saving, lower consumer expenditure and weak loan demand due to the COVID-19 pandemic, had the impact of increasing the Group's surplus liquidity position in 2020. Due to the high level of uncertainty regarding funding and liquidity developments at the outset of the pandemic, the Group activated it's Contingency Funding Plan ('CFP'), the CFP has since been deactivated. In addition the Group engaged in the following activities:

- Enhanced funding and liquidity monitoring and reporting through daily updates provided to the COVID-19 Liquidity Working Group. This was escalated up to the wider bank-wide COVID-19 incident management response.
- The suite of liquidity stress tests performed to assess the full range of potential adverse outcomes was broadened to consider the pandemic.

Monitoring, escalating and reporting

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

Liquidity risk stress testing

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

The Group also monitors a suite of Recovery Indicators and Early Warning Indicators in order to identify the potential emergence of a liquidity stress. As part of its contingency and recovery planning the Group has identified a suite of potential funding and liquidity options which could be exercised to help the Group to restore its liquidity position on the occurrence of a major stress event.

Encumbrance

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

The Bank had an encumbrance ratio of 71% at 31 December 2020 (2019: 61%). The encumbrance level is based on the amount of assets that are required in order to meet regulatory and contractual commitments.

Financial liabilities by undiscounted contractual maturity*

The following table analyses, on an undiscounted basis, financial liabilities by remaining contractual maturity at 31 December 2020 and 2019:

						2020
	Repayable on demand	**3 months or less but not repayable on demand**	**1 year or less but over 3 months**	**5 years or less but over 1 year**	**Over 5 years**	**Total**
	€m	**€m**	**€m**	**€m**	**€m**	**€m**
Deposits by banks	**4,914**	**—**	**—**	**—**	**—**	**4,914**
Customer accounts	**1**	**—**	**—**	**—**	**—**	**1**
Derivative financial instruments	**—**	**—**	**—**	**—**	**—**	**—**
Debt securities in issue	**—**	**—**	**1,150**	**5,750**	**3,775**	**10,675**
Subordinated liabilities	**—**	**—**	**—**	**—**	**300**	**300**
Other liabilities		**22**	**3**	**18**	**9**	**52**
Total	**4,915**	**22**	**1,153**	**5,768**	**4,084**	**15,942**
Off-balance sheet loan commitments	**559**	**—**	**—**	**—**	**—**	**559**

3.2 Funding and liquidity risk (continued)
Financial liabilities by undiscounted contractual maturity* (continued)

						2019
	Repayable on demand	3 months or less but not repayable on demand	1 year or less but over 3 months	5 years or less but over 1 year	Over 5 years	Total
	€m	€m	€m	€m	€m	€m
Deposits by banks	6,492	—	—	—	—	6,492
Customer accounts	1	—	—	—	—	1
Derivative financial instruments	—	—	—	—	1	1
Debt securities in issue	—	—	750	4,900	3,775	9,425
Subordinated liabilities	—	—	—	—	300	300
Other liabilities	—	23	8	29	9	69
Total	6,493	23	758	4,929	4,085	16,288
Off-balance sheet loan commitments	595	—	—	—	—	595

3.3 Capital adequacy risk*

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

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

3.4 Financial risk - Market risk

Interest rate risk in the banking book ('IRRBB') is the current or prospective risk to both the earnings and capital of the Bank as a result of adverse movements in interest rates being applied to positions held in the banking book. Changes in interest rates impact the underlying value of the assets, liabilities and off-balance sheet instruments and, hence, its economic value (or capital position). Similarly, interest rate changes will impact the Bank’s net interest income through interest-sensitive income and expense effects.

The Bank is exposed to interest rate risk arising from mortgage lending activities and the issuance of Mortgage Covered Securities. Interest rate swaps, as explained in the paragraphs below, are used to manage this exposure. The Bank is not allowed to engage in proprietary trading under the conditions of the Asset Covered Securities Act and its license. The interest rate exposure of the Bank relating to its Irish residential lending is managed using two interest rate swaps with AIB, one of which, the Pool Hedge, relates only to the Pool 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 AIB 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 Bank to terminate the swaps without cost on any reset date. The interest rate exposure of the Bank relating to fixed rate Mortgage Covered Securities issued by the Bank are hedging using interest swaps with AIB.

3.4 Financial risk - Market risk (continued)

There is some residual interest rate risk in the Bank. This interest rate risk is transferred centrally to Treasury and Group ALM for management, subject to review and oversight by Group ALCo. Treasury proactively manages the market risk on AIB's balance sheet, Market risk is managed against a range of limits approved at Group ALCo, which incorporate forward-looking measures such as VaR limits and stress test limits and financial measures such embedded value limits. AIB Treasury and Group ALM document an annual Risk Strategy and Appetite Statement as part of the annual financial planning cycle which ensures AIB's market risk aligns with AIB's strategic business plan. The total nominal values of the swaps are set out in note 14 to the financial statements. The Bank is not exposed to any other market risks, i.e. foreign exchange rates or equity prices.

3.4 Financial risk - Market risk

Interest Rate Exposure and Sensitivity*

The net interest rate exposure of the Bank at 31 December 2020 analysed by the earlier of the repricing and the contractual maturity date is illustrated in the following table:

										2020
	0≤1mth	1≤3mths	3≤12mths	1≤2yrs	2≤3yrs	3≤4yrs	4≤5yrs	5yrs+	Non-interest bearing	Total
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Assets										
Loans and advances to customers	13,688	51	194	368	815	575	1,702	92	(320)	17,165
Loans and advances to banks	70	—	—	—	—	—	—	—	—	70
Derivatives and other financial instruments	—	—	—	—	—	—	—	—	52	52
Other assets	—	—	—	—	—	—	—	—	37	37
Total assets	13,758	51	194	368	815	575	1,702	92	(231)	17,324
Liabilities										
Deposits by banks	4,914	—	—	—	—	—	—	—	—	4,914
Customer accounts	—	—	—	—	—	—	—	—	1	1
Debt securities in issue	8,400	500	—	750	1,000	—	—	25	—	10,675
Subordinated liabilities	300	—	—	—	—	—	—	—	—	300
Other liabilities	—	—	—	—	—	—	—	—	136	136
Shareholders' equity	—	—	—	—	—	—	—	—	1,298	1,298
Total liabilities and equity	13,614	500	—	750	1,000	—	—	25	1,435	17,324
Derivatives affecting interest rate sensitivity	(1,530)	(440)	194	(383)	(185)	575	1,702	67	—	—
Interest sensitivity gap	1,674	(9)	—	1	—	—	—	—	(1,666)	—
Cumulative interest sensitivity gap	1,674	1,665	1,665	1,666	1,666	1,666	1,666	1,666	—	—

The impact on net interest income over a twelve month period of a 100 bps downward/upward movement in interest rates on 31 December 2020 would be circa -€7m/€13m respectively.

3.4 Financial risk - Market risk

Interest Rate Exposure and Sensitivity* (continued)

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

										2019
	0≤1mth	1≤3mths	3≤12mths	1≤2yrs	2≤3yrs	3≤4yrs	4≤5yrs	5yrs+	Non-interest bearing	Total
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Assets										
Loans and advances to customers	15,578	68	270	328	434	222	693	150	(209)	17,534
Loans and advances to banks	85	—	—	—	—	—	—	—	—	85
Derivatives and other financial instruments	—	—	—	—	—	—	—	—	64	64
Other assets	—	—	—	—	—	—	—	—	119	119
Total assets	15,663	68	270	328	434	222	693	150	(26)	17,802
Liabilities										
Deposits by banks	6,492	—	—	—	—	—	—	—	—	6,492
Customer accounts	—	—	—	—	—	—	—	—	1	1
Derivatives and other financial instruments	—	—	—	—	—	—	—	—	1	1
Debt securities in issue	6,400	—	750	500	750	1,000	—	25	—	9,425
Subordinated liabilities	300	—	—	—	—	—	—	—	—	300
Other liabilities	—	—	—	—	—	—	—	—	305	305
Shareholders' equity	—	—	—	—	—	—	—	—	1,278	1,278
Total liabilities and equity	13,192	—	750	500	750	1,000	—	25	1,585	17,802
Derivatives affecting interest rate sensitivity	854	74	(480)	(172)	(316)	(778)	693	125	—	—
Interest sensitivity gap	1,617	(6)	—	—	—	—	—	—	(1,611)	
Cumulative interest sensitivity gap	1,617	1,611	1,611	1,611	1,611	1,611	1,611	1,611	—	

The impact on net interest income over a twelve month period of a 100 bps downward/upward movement in interest rates on 31 December 2019 would be circa -€9m/€9m respectively.

3.5 Operational risk

Operational risk is the risk arising from inadequate or failed internal processes, people and systems or from external events. This includes legal risk – the potential for loss arising from the uncertainty of legal proceedings and potential legal proceedings, but excludes strategic and reputational risk.

Risk and Control Assessment ('RCA') is a core process in the identification and assessment of operational risk across AIB Group. The process serves to ensure that key risks are proactively identified, evaluated, monitored and reported, and that appropriate action is taken. Self-assessment of risks is completed at business unit level and is recorded on SHIELD which is AIB's governance, risk and compliance ('GRC') system. SHIELD provides all areas with one consistent view of the risks, controls, actions and events across AIB. RCAs are regularly reviewed and updated by business unit management. A materiality matrix is in place to enable the scoring of risks, and action plans must be developed to provide mitigants for the more significant risks. Monitoring processes are in place at business unit and support level. The group operational risk team sets and maintains policies and procedures for self-assessment and undertakes risk based reviews and testing to ensure the completeness and robustness of each business unit's self-assessment, and that appropriate attention is given to the more significant risks.

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

The key people, systems and processes supporting the Bank is governed by an Outsourcing and Agency Agreement. The Group's operational risk framework applies across all areas of the Group including the Bank. The Group's Operational Risk function is responsible for overseeing the management of operational risk across the Group. A key focus of operational risk management in the Bank is the oversight of outsourced service activities, in particular activities related to the requirements of the ACS Act, as well as the end-to-end mortgage origination and servicing processes.

The objective of operational risk reporting is to provide the Board with a timely and pertinent update on the Operational Risk profile, in order to assist the Board in discharging its responsibilities for the oversight of risk. A secondary objective is to provide senior management with an overview of the Operational Risk profile, in order to support the effective management of risks.

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

In response to COVID-19 new ways of working, including the vast majority of staff members working from home, of interacting with the Group's customers, and changes required to support delivery of customer services have presented challenges from an operational risk management and measurement perspective. COVID-19 has impacted on all drivers of operational risk, however significant effort and resources have been committed to ensure the Group's operational risk management approach and systems remain robust.

3.6 Regulatory compliance risk

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

The Group's Regulatory Compliance function is specifically responsible for independently identifying, assessing current and forward looking compliance obligations, as well as financial crime regulation, regulation on privacy and data protection. The Regulatory Compliance function operates a risk framework approach. Regulatory Compliance function also ensure clear reporting to the Board through the presentation of the Risk Report on a quarterly basis which details risk profiles, key regulatory compliance risk drivers and outlines any issue resolution steps to ensure that the Board has sufficient and robust oversight of regulatory compliance and conduct risk

During 2020, the level of regulatory risk remained high, significant input to the assessment of COVID-19 solutions and measures designed to support the Bank's customers through this unprecedented crisis and to ensure key risks, mitigants and controls were identified and communicated. Throughout this period, Regulatory Compliance Risk Appetite Statement metrics were closely monitored.

The Bank is committed to proactively identifying regulatory and compliance obligations arising in its operating markets in Ireland, and ensuring the timely implementation of regulatory change. The level of regulatory change is expected to remain at high levels in 2021 and beyond.

3.7 Conduct risk
Conduct risk is defined as the risk that inappropriate actions or inactions by the Bank cause poor and unfair customer outcomes or market instability.

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

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

During 2020 in response to COVID-19 the Group identified and implemented steps to support and protect its customers. A number of potential conduct risk drivers and managing customer rights were overseen and monitored throughout the COVID-19 crisis. Regulatory Compliance monitored and reported the impact of COVID-19 on the Risk Appetite Statement metrics, taking into account key factors including the volume of customer engagements, the increased number of vulnerable customers and the range of measures taken to assist good customer outcomes and market stability.

3.8 People and culture risk
People and culture risk is the risk to achieving the Bank's strategic objectives as a result of an inability to recruit, retain or develop resources, or as a result of behaviours associated with low levels of employee engagement. It also includes the risk that the business, financial condition and prospects of the Bank are materially adversely affected as a result of inadvertent or intentional behaviours or actions taken or not taken by employees that are contrary to the overall strategy, culture and values of the Bank. The majority of business activities of the Bank are outsourced to the Group under a Managed Services Agreement.

The Group identifies and reviews employee satisfaction and engagement which are indicators of culture throughout the year. Due to disruption of the working environment as a result of COVID-19 there was additional staff engagement activities in place including regular staff check-in’s and a staff engagement survey carried out in both the first and second half of 2020. A detailed Wellness Programme operated throughout the year with the launch in 2020 to all staff of the PepTalk Wellness App, with specific content which has significantly enhanced the wellness offering.

In 2017 the Group launched its ‘Purpose’, which is supported and embedded by a clear set of values. The Group’s Code of Conduct, incorporating the risk culture principles, places great emphasis on the integrity of employees and accountability for both actions taken and inaction. The Code sets out how employees are expected to behave in terms of the business, customer and employee.

The Group has made significant steps in increasing engagement and awareness of the Group’s risk management activities by embedding the risk appetite statement in the policies and frameworks. The risk appetite statement contains clear statements of intent as to the Group's appetite for taking and managing risk.

COVID-19 presented unique challenges during 2020 including the vast majority of staff members working from home and significant changes to the working environment to facilitate those that needed to attend branches and offices. The Group rolled out new and enhanced teleconferencing facilities and provided laptops to staff working remotely.

3.9 Business model risk
The risk of not achieving the agreed strategy or approved business plan either as a result of an inadequate implementation plan, or failure to execute the implementation plan as a result of inability to secure the required investment, or due to factors in the economic, political, competitive or regulatory environment. This also includes the risk of implementing an unsuitable strategy, or maintaining an obsolete business model, in light of known internal and external factors.

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

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

3.9 Business model risk

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

Performance against plan is monitored at Bank level by executive management and Board on a quarterly basis. Risk profile against risk appetite measures, some of which reference performance against plan, is monitored monthly by the Group Risk Function, with breaches of Risk Appetite relating to the Bank reported on a monthly basis to the Group Risk Committee. The Bank's Risk Appetite is also reported to the Bank's Executive Management and Board.

2020 developments in response to COVID-19
A number of actions were taken throughout 2020 in response to the COVID-19 pandemic. These included more frequent monitoring of certain key Risk Appetite Statement metrics, early review of the calibration of key Risk Appetite Statement metrics to reflect changes in the external environment, and a conservative risk posture, in addition to detailed assessment of the risks relating to the pandemic through our stress testing and Financial Planning processes.

3.10 Model risk

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

The Board of AIB has ultimate accountability for ensuring that the models used by the Group are fit for purpose and meet all jurisdictional regulatory and accounting standards. The Group are also responsible for ensuring that there are appropriate policies in place relating to capital assessment, measurement and allocation. Operating to the principles outlined in the Model Risk Framework supports the Group’s strategic objectives and provides comfort to the Board on the integrity and completeness of the model risk governance.

The Group mitigates model risk by having a framework, policies and standards in place in relation to model development, operation, and validation together with suitable resources. The Model Risk Framework is designed to ensure that model risk in the Group is properly identified and managed across each step of the model lifecycle and is aligned to Group’s Risk Management Framework.

Models are built by suitably qualified analytical personnel, informed by relevant business and finance functions. Models are built using the best available data, both internal and external, using international industry standard techniques. All models are validated by an appropriately qualified team, which is independent of the model build process.

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

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

During 2020, two significant areas of challenge for model risk as a result of COVID-19 were the re-prioritisation of activities for business subject matter experts to support the roll-out of new customer solutions (e.g. payment breaks) and away from providing business support for model development and understanding the impact of COVID-19 on the performance of risk models. There was no material incremental impact on Model Risk from Brexit during 2020.

These risks were mitigated by re-planning activities appropriately in order to ensure the Group's model development priorities were reviewed and that model developments continued on an appropriate timeline. Additionally, ongoing monitoring of models continued through 2020 to ensure that any changes in model performance as a result of COVID-19 were identified. Specifically in relation to ECL, post model adjustments have been made to appropriately reflect management's best estimate of the economic implications arising from COVID-19, including where model limitations exist. See pages 27 to 29 for more detail on the post model adjustments that have been applied.

Directors’ responsibility statement

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

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

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

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

- select suitable accounting policies for the Bank's 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 to 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.

Conor McGrath
Executive Director (Managing)

Yvonne Hill
Independent Non-Executive Director

Date: 3 March 2021

Independent Auditor's report to the members of AIB Mortgage Bank Unlimited Company

Report on the audit of the financial statements

Opinion on the financial statements of AIB Mortgage Bank Unlimited Company (the 'Company')

In our opinion, the financial statements:

- give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2020 and of the profit of the Company for the financial year then ended; and
- have been properly prepared in accordance with the relevant financial reporting framework and, in particular, with the requirements of the Companies Act 2014.

The financial statements we have audited comprise:

- the income statement;
- the statement of comprehensive income;
- the statement of financial position;
- the statement of changes in shareholders' equity;
- the statement of cash flows; and
- the related notes 1 to 37, including a summary of accounting policies as set out in note 1.

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

Basis of opinion

We conducted our audit in accordance with International Standards on Auditing (Ireland) (ISAs (Ireland)) and applicable law. Our responsibilities under those standards are described below in the "Auditor's responsibilities for the audit of the financial statements" section of our report.

We are independent of the Company in accordance with the ethical requirements that are relevant to our audit of the financial statements in Ireland, including the Ethical Standard issued by the Irish Auditing and Accounting Supervisory Authority (IAASA), as applied to public interest entities, and we have fulfilled our other ethical responsibilities in accordance with these requirements.

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

Summary of our audit approach

Key audit matters	The key audit matters that we identified in the current year were: • Expected credit losses on loans and advances to customers; • Provision for FSPO decision and tracker mortgage examination; and • IT systems and controls. Within this report, any new key audit matters are identified with and any key audit matters which are the same as the prior year are identified with .
Materiality	We determined materiality to be € 13 million which is approximately 1% of total shareholders' equity of the Company;
Significant changes in our approach	*Impact of COVID-19 on our audit approach* As the COVID-19 pandemic continues to spread globally it has had an impact on all elements of local and international economies. We have considered the impact of COVID-19 on the Company's business as part of our audit risk assessment and planning. This assessment resulted in an increased audit scope on key audit areas including: • consideration of changes in internal controls (including IT systems) as a result of the remote working environment; • additional focus on the key judgements and estimates driving expected credit losses on loans and advances to customers; and • the impact of the Company's revised profitability and growth forecasts covering the period 2021 to 2023.

Independent Auditor's report to the members of AIB Mortgage Bank Unlimited Company

Conclusions relating to going concern

In auditing the financial statement we have concluded that the Directors' use of the going concern basis of accounting in the preparation of the financial statements is appropriate;

Our evaluation of the Directors' assessment of the Company's ability to continue to adopt the going concern basis of accounting included consideration of the inherent risks to the Company's business model and we analysed how those risks might affect the Company's financial resources or ability to continue operations over the going concern period. The risks that we considered most likely to adversely affect the Company's available financial resources over this period were:

- availability of funding and liquidity in the event of a market wide stress scenario including the longer term impacts of COVID-19 and post Brexit EU/UK trade deal on the economy; and
- impact on regulatory capital requirements in the event of an economic slowdown or recession.

As these were risks that could potentially cast significant doubt on the Company's ability to continue as a going concern, our evaluation of the Directors' assessment included:

- evaluating the design and determining the implementation of key controls over the preparation of financial plans and budgets;
- understanding the Company's Capital and Liquidity process including under stressed scenarios;
- obtaining the updated financial planning exercise covering the period 2021 to 2023 undertaken in the second half of 2020;
- assessing whether the level of forecasted profits in the updated financial plan were appropriate by challenging the growth, profitability and economic assumptions;
- testing the accuracy of Management's forecasting process by reviewing previous forecasts and comparing to actual results;
- challenging the key assumptions used in the Directors assessment of the Company's ability to continue as a going concern;
- considering the letter of support provided by Allied Irish Banks, p.l.c. to the Company; and
- evaluating the adequacy of the relevant disclosures made in the financial statements.

Based on the work we have performed, we have not identified any material uncertainties relating to events or conditions that, individually or collectively, may cast significant doubt on the Company's ability to continue as a going concern for a period of at least twelve months from the date when the financial statements are authorised for issue.

Our responsibilities and the responsibilities of the Directors with respect to going concern are described in the relevant sections of this report.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current financial year and include the most significant assessed risks of material misstatement (whether or not due to fraud) we identified, including those which had the greatest effect on: the overall audit strategy, the allocation of resources in the audit; and directing the efforts of the engagement team. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Expected credit losses on loans and advances to customers	
Key audit matter description	In line with IFRS 9, losses on financial assets which are classified at amortised cost are recognised on an Expected Credit Loss ('ECL') basis. ECLs are required to incorporate forward looking information, reflecting Management's view of potential future economic environments. The complexity involved in the calculations require Management to develop methodologies involving the use of significant judgements. Expected credit loss allowances on loans and advances to customers was € 320 million at 31 December 2020 (2019: € 210 million). Measurement of the ECL allowance on loans and advances to customers is a key audit matter as the determination of assumptions for ECLs is highly subjective due to the level of judgement applied by Management. The most significant judgements include: • Determining the criteria for a significant increase in credit risk ('SICR'), and for being classified as credit impaired; • Accounting interpretations and assumptions used to build the models that calculate the ECL; • The determination of key assumptions, including collateral valuation and cash flow timings, used in discounted cash flows ('DCFs') of individually assessed loans; • The completeness and accuracy of data used to calculate the ECL; • The completeness and valuation of post-model adjustments determined by Management for certain higher risk portfolios and to address known model limitations; and • Establishing the number and relative weightings for forward looking macroeconomic scenarios applied in measuring the ECL. This is highly subjective given that such assumptions are subject to significant uncertainty related to future economic outcomes, including the potential longer term impacts of COVID-19 and post Brexit EU/UK trade deal on the economy. This results in a wide range of possible outcomes. Please also refer to: page 75 - Accounting Policy (1.13) - Impairment of financial assets, note 2 - Critical accounting judgements and estimates, note 11 - Net credit impairment charge, and note 16 - Loans and advances to customers.
How the scope of our audit responded to the key audit matter	We tested the operating effectiveness of key controls supporting the calculation of ECLs on loan and advances to customers focusing on: • Model development, validation and approval to ensure compliance with IFRS 9 requirements; • Review and approval of key assumptions, judgements and macroeconomic forward looking information used in the models; • The integrity of data used as input to the models including the transfer of data between source systems and the ECL models; • The application of SICR criteria and the definition of default used to determine stage outcomes; • Governance and approval of post-model adjustments recorded by Management; • Governance and approval of the output of IFRS 9 models; and • Front line credit monitoring and assessment controls including annual case file reviews. Our testing included an evaluation of the design and implementation of these key controls. Where control deficiencies were identified we tested compensating controls implemented to produce the ECLs and financial statement disclosures. We also assessed Management review controls and governance controls including attendance at and observation of AIB Board Risk Committee and AIB Group Credit Committee meetings. We evaluated IT system controls including assessing data inputs and general IT controls. We tested the completeness and accuracy of key data inputs and reconciled to source systems, where appropriate. We critically assessed the ECL models employed by the Company. In conjunction with Deloitte credit modelling specialists, we challenged judgements and assumptions supporting the ECL requirements of IFRS 9. These included assumptions used in the ECL models applied in stage allocation, calculation of lifetime probability of default and methods applied to derive loss given default rates. We evaluated the methodology and performed code reviews for a sample of models.

How the scope of our audit responded to the key audit matter	We assessed the reasonableness of forward looking information incorporated into the impairment calculations. We challenged the macroeconomic scenarios chosen and changes to the weightings applied. This included benchmarking the economic data used to recognised external data sources. We also considered the impact of key uncertainties, including Brexit as well as assumptions made by Management around a 'Global Slowdown' scenario. We considered material post-model adjustments applied by Management to address model and data limitations. We challenged the rationale for these adjustments and performed testing on their calculation and application. In examining a risk based sample of DCF individually assessed loan cases, we challenged Management on the judgements made regarding the application of the default policy, status of loan restructures, collateral valuation and realisation time frames and examined the credit risk functions analysis of data at a portfolio level. Where appropriate, this work involved assessing third party valuations of collateral, internal valuation guidelines derived from benchmark data, external expert reports on borrowers' business plans and enterprise valuations. This allowed us to determine whether appropriate valuation methodologies were used and to assess the objectivity of the external experts used. We considered significant items impacting the ECL allowance balance. This included portfolio sales and non-contracted write-offs, as well as recoveries on amounts previously written-off. We evaluated the adequacy of disclosures made in the financial statements. In particular, we focused on challenging Management that the disclosures were sufficiently clear in highlighting the significant uncertainties that exist in respect of the ECL allowance and the sensitivity of the allowance to changes in the underlying assumptions. Based on the evidence obtained, we found that the ECLs on loans and advances to customers are within a range we consider to be reasonable.

Provision for tracker mortgage examination	
Key audit matter description	The calculation of provisions for Financial Services Pension Ombudsman ('FSPO') decision and the tracker mortgage examination is highly judgemental and involves the use of several Management assumptions including the identification of relevant impacted customers and related redress costs. There is also a risk that known and emerging issues may not be appropriately disclosed in the financial statements. As a result, we consider this a key audit matter. Included in note 24 - Provisions for liabilities and commitments the Company has recorded a provision of € 76 million (2019: € 236 million) for customer redress and compensation. Please refer to: page 77 - Accounting Policy (1.16) - Non-credit risk provisions, note 2 - Critical accounting judgements and estimates, note 24 - Provisions for liabilities and commitments, and note 31 - Contingent liabilities and commitments.
How the scope of our audit responded to the key audit matter	We have evaluated the design and determined the implementation of the Company's relevant controls over the identification, measurement and the disclosure of the provision. We also assessed Management review and governance controls. We reviewed the correspondence with regulators, the Financial Services and Pensions Ombudsman ('FSPO') and legal advice obtained. We assessed Management's interpretation of the impact of this decision. We reviewed the basis for recording and retaining a provision taking into consideration the information available and the requirements of IAS 37. We also considered Management's interactions with regulators including the status of the Central Bank of Ireland enforcement process. Given the inherent uncertainty in the calculation of the provision and its judgemental nature, we evaluated the adequacy of disclosures made in the financial statements. We challenged Management on the disclosures, in particular, whether they are sufficiently clear in highlighting the exposures that remain, the significant uncertainties that exist in respect of the provisions and the sensitivity of the provisions to changes in the underlying assumptions. Based on the evidence obtained, we found that the assumptions used by Management in measurement of the provision for the tracker mortgage examinations are within a range we consider to be reasonable.

IT systems and controls	
Key audit matter description	The Company's financial reporting processes are reliant on processes, controls and data managed by IT systems. The IT environment is complex and pervasive to the operations of the Group due to the large volume of transactions processed daily and the reliance on automated and IT dependent manual controls. This risk is also impacted by dependency on third parties and outsourced arrangements. Our planned audit approach relies extensively on IT applications and the operating effectiveness of the control environment. As part of our assessment of the IT environment, we considered privileged user access management controls to be critical in ensuring that only appropriately authorised changes are made to relevant IT systems. Moreover, appropriate access controls contribute to mitigating the risk of potential fraud or error as a result of changes to applications or processing unauthorised transactions. In addition the COVID-19 pandemic has led to changes in operation of certain key controls due to the increased number of employees working remotely. We regard this area as a key audit matter owing to the high level of IT dependency within the Company, as well as the associated complexity and the risk that automated controls are not designed and operating effectively.
How the scope of our audit responded to the key audit matter	We examined the design of the governance framework associated with the Company's IT architecture. We gained an understanding and tested relevant General IT Controls for systems. We considered relevant to the financial reporting process, including access management, programme development and change management. We gained an understanding of relevant IT controls over applications, operating systems and databases that are relevant for the financial reporting process and tested their operating effectiveness. We assessed the relevant automated controls within business processes and the reliability of relevant reports used as part of manual controls. This included assessing the integrity of system interfaces, the completeness and accuracy of data feeds and automated calculations. We tested user access by assessing the controls in place for in-scope applications and verifying the addition and removal of users. While we identified certain design and operating effectiveness deficiencies in relation to user access controls, we tested validation activities performed by Management and compensating controls to mitigate the risk of fraud or error as a result of unauthorised transactions. Based on this testing we were able to place reliance on IT controls for the purpose of our audit.

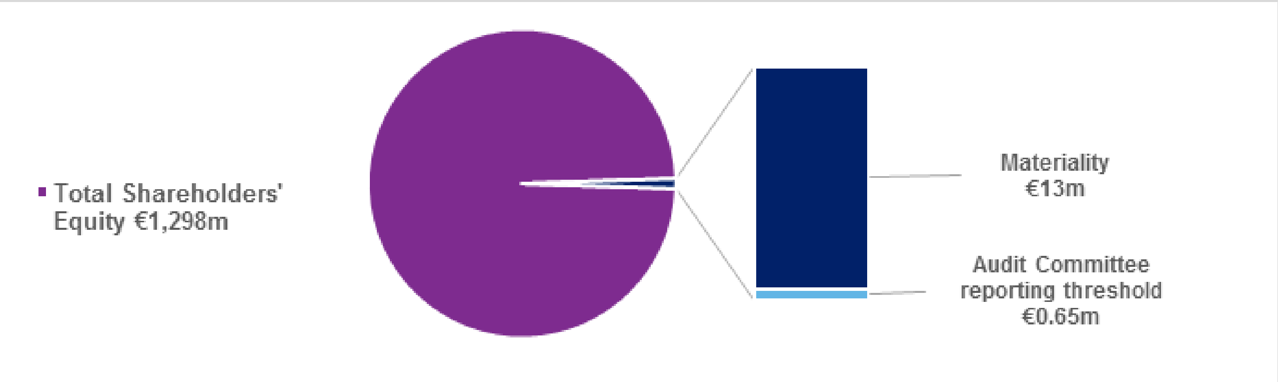
Our audit procedures relating to these matters were designed in the context of our audit of the financial statements as a whole, and not to express an opinion on individual accounts or disclosures. Our opinion on the financial statements is not modified with respect to any of the risks described above,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

Our application of materiality

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

We determined materiality for the Company to be € 13m which is approximately 1% of Total shareholders' equity. We have considered shareholders' equity to be the critical component for determining materiality. We used this benchmark taking into consideration the nature of the Company's operations as being primarily for funding purposes. We have considered quantitative and qualitative factors such as understanding the entity and its environment, history of misstatements, complexity of the Company and the reliability of control environment.

We agreed with the Audit Committee that we would report to them any audit differences in excess of €0.65 million, as well as differences below that threshold which, in our view, warranted reporting on qualitative grounds. We also report to the Audit Committee on disclosure matters that we identified when assessing the overall presentation of the financial statements.



An overview of the scope of our audit

We determined the scope of our audit by obtaining an understanding of the Company and its environment, including the controls operating within the Company, and assessing the risks of material misstatement related to the financial statements of the Company.

We have considered the impact of COVID-19 on the Company's business as part of our audit risk assessment and planning. This assessment resulted in an increased audit scope on key audit areas including: consideration of changes in internal controls (including IT systems) as a result of the remote working environment; additional focus on the key judgements and estimates driving expected credit losses on loans and advances to customers; and the impact of the Company's revised profitability and growth forecasts covering the period 2021 to 2023.

The risks of material misstatement that had the greatest effect on our audit are identified as key audit matters in the table above.

Other information

The other information comprises the information included in the Directors' Report and Annual Financial Statements other than the financial statements and our auditor's report thereon. The Directors are responsible for the other information contained within the Directors' Report and Annual Financial Statements.

Our opinion on the financial statements does not cover the other information and, except to the extent otherwise explicitly stated in our report, we do not express any form of assurance conclusion thereon.

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

We have nothing to report in this regard.

Independent Auditor's report to the members of AIB Mortgage Bank Unlimited Company

Responsibilities of Directors

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, and for such internal control as the Directors determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the financial statements, the Directors are responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless the Directors either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the financial statements

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

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

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

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

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

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

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

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

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

Independent Auditor's report to the members of AIB Mortgage Bank Unlimited Company

Auditor's responsibilities for the audit of the financial statements (continued)

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

Report on other legal and regulatory requirements

Opinion on other matters prescribed by the Companies Act 2014

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

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

Corporate Governance Statement

We report, in relation to information given in the Corporate Governance Statement on pages 3 to 5 that:

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

Matters on which we are required to report by exception

Based on the knowledge and understanding of the Company and its environment obtained in the course of the audit, we have not identified material misstatements in the Directors' Report.

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

Other matters which we are required to address

Following the recommendation of the Audit Committee of AIB Mortgage Bank, we were appointed at the Annual General Meeting on 28 June 2013 to audit the financial statements for the financial year ended 31 December 2013. The period of total uninterrupted engagement including previous renewals and reappointments of the firm is 8 years, covering the years ending 2013 to 2020.

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

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

Independent Auditor's report to the members of AIB Mortgage Bank Unlimited Company

Use of our report

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

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

Date: 4 March 2021

Notes: An audit does not provide assurance on the maintenance and integrity of the website, including controls used to achieve this, and in particular on whether any changes may have occurred to the financial statements since first published. These matters are the responsibility of the directors but no control procedures can provide absolute assurance in this area.

Legislation in Ireland governing the preparation and dissemination of financial statements differs from legislation in other jurisdictions.

Income statement

for the financial year ended 31 December 2020

	Note	2020 €m	2019 €m
Interest income calculated using the effective interest method	3	**432**	435
Interest and similar expense	4	**(72)**	(124)
Net interest income		**360**	311
Net fee income	5	**—**	197
Net gain on other financial assets measured at FVTPL	6	**4**	2
Net gain/(loss) on derecognition of financial assets measured at amortised cost	7	**3**	(17)
Other operating income	8	**2**	2
Other Income		**9**	184
Total operating income		**369**	495
Administrative expenses	9	**(233)**	(393)
Operating profit before impairment writebacks and taxation		**136**	102
Net credit impairment (charge)/writeback	11	**(113)**	3
Operating profit before taxation from continuing operations		**23**	105
Income tax charge	12	**(3)**	(13)
Profit for the year		**20**	92

Statement of comprehensive income

for the financial year ended 31 December 2020

	2020 € m	2019 € m
Profit for the year	**20**	92
Other comprehensive income for the year	**—**	—
Total comprehensive income for the year	**20**	92

Statement of financial position

as at 31 December 2020

	Note	2020 €m	2019 €m
Assets			
Non-current assets held for sale	13	**2**	3
Derivative financial instruments	14	**52**	64
Loans and advances to banks	15	**70**	85
Loans and advances to customers	16	**17,165**	17,534
Other assets	17	**29**	113
Current taxation		**4**	—
Deferred taxation	18	**2**	3
Total assets		**17,324**	17,802
Liabilities			
Deposits by banks	19	**4,914**	6,492
Customer accounts	20	**1**	1
Derivative financial instruments	14	**—**	1
Debt securities in issue	21	**10,675**	9,425
Other liabilities	22	**32**	41
Accruals and deferred income	23	**28**	28
Provisions for liabilities and commitments	24	**76**	236
Subordinated liabilities	25	**300**	300
Total liabilities		**16,026**	16,524
Shareholders' equity			
Issued share capital presented as equity	26	**436**	436
Capital reserves	27	**580**	580
Revenue reserves		**282**	262
Shareholders' equity		**1,298**	1,278
Total liabilities and shareholders' equity		**17,324**	17,802

Conor McGrath
Executive Director (Managing)

Yvonne Hill
Independent Non-Executive Director

Date: 3 March 2021

Diane Lumsden
Company Secretary

Gerry Gaffney
Executive Director

Date: 6 March 2023

Statement of changes in shareholders’ equity

for the financial year ended 31 December 2020

	Ordinary share capital	Capital reserves	Revenue reserves	Total shareholders' equity
	€m	€m	€m	€m
At 1 January 2020	**436**	**580**	**262**	**1,278**
Total comprehensive income for the year				
Profit for the year	**—**	**—**	**20**	**20**
Other comprehensive income	**—**	**—**	**—**	**—**
At 31 December 2020	**436**	**580**	**282**	**1,298**
At 1 January 2019	1,745	580	161	2,486
Total comprehensive income for the year				
Profit for the year	—	—	92	92
Other comprehensive income	—	—	—	—
Capital reduction[1]	(1,309)	—	1,309	—
Capital repayment[1]		—	(1,300)	(1,300)
At 31 December 2019	436	580	262	1,278

[1]For details in relation to the capital reduction transaction see note 26. Issued share capital presented as equity.

Statement of cash flows

for the financial year ended 31 December 2020

	Note	2020 €m	2019 €m
Cash flows from operating activities			
Operating profit for the year before taxation		**23**	105
Adjustments for:			
Net credit impairment charge/(writeback)	11	**113**	(3)
Change in provisions for liabilities and commitments	24	**(160)**	225
		(24)	327
Changes in operating assets and liabilities			
Change in loans and advances to customers	16	**256**	356
Change in accruals and deferred income	23	**—**	(1)
Change in derivative financial instruments	14	**11**	—
Change in non-current assets held for sale	13	**1**	(2)
Change in other assets	17	**84**	(66)
Change in other liabilities	22	**(9)**	(3)
Net cash flows from operating assets and liabilities		**343**	284
Net cash flows from operations before taxation		**319**	611
Taxation paid		**(6)**	(15)
Net cash flows from operations		**313**	596
Cash flows from investing activities			
Net cash flows from investing activities		**—**	—
Cash flows from financing activities			
Change in debt securities in issue	21	**1,250**	(565)
Change in deposits by banks	19	**(1,578)**	1,258
Capital reduction	26	**—**	(1,300)
Net cash flows from financing activities		**(328)**	(607)
Change in cash and cash equivalents		**(15)**	(11)
Cash and cash equivalents at 1 January		**85**	96
Cash and cash equivalents at 31 December *	29	**70**	85

*Cash and cash equivalent balances include funds held as collateral for derivatives with AIB of €50m in 2020 (2019: €65m) and Cash Substitution Pool Assets with Barclays Bank Ireland p.l.c. of €20m in 2020 (2019: €20m). See note 15. Loans and advances to banks.

Notes to the financial statements

Notes to the financial statements

Accounting policies index

Notes to the financial statements

1. ACCOUNTING POLICIES

The accounting policies applied in the preparation of the financial statements for the financial year ended 31 December 2020 are set out below.

1.1. Reporting entity

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. The Bank's registered office was changed to 10 Molesworth Street, Dublin 2, Ireland on 16 June 2020 (previously Bankcentre, Ballsbridge, Dublin 4, Ireland) and it is registered under the company number 404926. It is a wholly owned subsidiary of AIB which is a wholly owned subsidiary of AIB Group plc, and is regulated by the Single Supervisory Mechanism ('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 branch network in the Republic of Ireland or may be purchased from AIB and other members of AIB 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 adopted by the European Union ('EU') and applicable for the financial year ended 31 December 2020. 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 and Article 4 of the IAS Regulation. The accounting policies have been consistently applied by the Bank and are consistent with the previous year, unless otherwise described.

1.3. Basis of preparation

Functional and presentation currency

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

Basis of measurement

The financial statements have been prepared under the historical cost basis, with the exception of the following assets and liabilities which are stated at their fair value: derivative financial instruments, 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, Financial Instruments: Disclosures and IAS 1, Presentation of Financials Statements 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 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'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 ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised and in any future period affected. The estimates that have a significant effect on the financial statements and estimates with a significant risk of material adjustment in the next year are in the areas of expected credit losses on financial instruments and provisions for liabilities and commitments.

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

Going concern

The financial statements for the financial year ended 31 December 2020 have been prepared on a going concern basis as the Directors are satisfied, having considered the principal risks and uncertainties impacting the Bank, that it has the ability to continue in business for the period of assessment. In making this assessment, the Directors have considered a wide range of information relating to present and future conditions, including internally generated stress scenarios, cognisant of the prolonged impacts of COVID-19 and Brexit. The period of assessment used by the Directors is twelve months from the date of approval of these annual financial statements.

The Bank is dependent on AIB for continued funding and is therefore dependent on the going concern status of the parent. The financial statements of AIB have been prepared on a going concern basis.

1. ACCOUNTING POLICIES

1.3. Basis of preparation (continued)

Going concern (continued)

There is no intention to liquidate the company or cease trading and the Bank is not aware of any material uncertainties related to conditions or events that may cast significant doubt upon the company's ability to continue as a going concern. In addition, the Bank's parent AIB has provided a letter of financial support to the Directors.

Conclusion

On the basis of the continued availability of funding from AIB to the Bank, the Board approved financial plans in base and alternative scenarios, and notwithstanding the potential impact of COVID-19 to impact the performance of the Bank, the Directors of the Bank believe that it is appropriate to prepare the financial statements on a going concern basis.

Adoption of new accounting standards/amendments to standards

During the financial year to 31 December 2020, the Group adopted the following amendments to standards and interpretations which had an insignificant impact on these annual financial statements:

- Amendments to IFRS 3 Business Combinations (definition of a business);
- Amendments to References to the Conceptual Framework in IFRS Standards; and
- Amendments to IFRS 16 Leases Covid-19 Related Rent Concessions.

1.4. Interest income and expense recognition

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

Effective interest rate

The effective interest rate is the rate that exactly discounts the estimated future cash payments or receipts through the expected life of the financial instrument to:

- the gross carrying amount of the financial asset; or
- the amortised cost of the financial liability.

The application of the method has the effect of recognising income receivable and expense payable on the instrument evenly in proportion to the amount outstanding over the period to maturity or repayment. In calculating the effective interest rate for financial instruments other than credit impaired assets, the Bank estimates cash flows (using projections based on its experience of customers' behaviour) considering all contractual terms of the financial instrument but excluding expected credit losses. The calculation takes into account all fees, including those for any expected early redemption, and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums and discounts.

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

Amortised cost and gross carrying amount

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

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

Calculation of interest income and interest expense

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

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

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

When a financial asset is no longer credit impaired or has been repaid in full (i.e. cured without financial loss), the Bank presents previously unrecognised interest income as a reversal of credit impairment/recovery of amounts previously written-off.

1. ACCOUNTING POLICIES

1.4. Interest income and expense recognition (continued)

Presentation

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

1.5. Net fee income

The measurement and timing of recognition of fee income is based on the core principles of IFRS 15 Revenue from Contracts with Customers.

The principles in IFRS 15 are applied using the following 5 step model:
- Identify the contract(s) with a customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contract; and
- Recognise revenue when or as the Group satisfies its performance obligations.

Fee income is recognised when the performance obligation in the contract has been performed, 'point in time' recognition, or 'over time' recognition if the performance obligation is performed over a period of time unless the income has been included in the effective interest rate calculation.

During 2020 the Bank implemented an updated pricing agreement with AIB to reflect revised OECD guidelines on transfer pricing, which are the internationally accepted principles in this area, and which take account of the functions, risks and assets involved, for 2020 this required a net payment by the Bank to AIB (2019: net receipt by the Bank from AIB).

Portfolio and other management advisory and service fees are recognised based on the applicable service contracts.

1.6. Net trading income

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

1.7. 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 provide 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.

Deferred income tax is provided on temporary differences arising from the transition to IFRS 9.

In addition, temporary differences are not provided for assets and liabilities the initial recognition of which, in a transaction that is not a business combination, affects neither accounting nor taxable profit. Income tax payable on profits, based on the applicable tax law, is recognised as an expense in the period in which the profits arise.

1. ACCOUNTING POLICIES

1.8. Financial assets

Recognition and initial measurement

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

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

Derivatives are measured initially at fair value on the date on which the derivative contract is entered into. The best evidence of the fair value of a derivative at initial recognition is the transaction price (i.e. the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets. Profits or losses are only recognised on initial recognition of derivatives when there are observable current market transactions or valuation techniques that are based on observable market inputs.

Classification and subsequent measurement

On initial recognition, a financial asset is classified and subsequently measured at amortised cost, FVOCI or FVTPL.
The classification and subsequent measurement of financial assets depend on:
– The Bank's business model for managing the asset; and
– The cash flow characteristics of the asset (for assets in a ‘hold-to-collect’ or ‘hold-to-collect-and-sell’ business model).

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

- Amortised cost

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

- Fair value through other comprehensive income ('FVOCI')

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

- Fair value through profit or loss ('FVTPL')

Financial assets that do not meet the criteria for amortised cost or FVOCI are measured at FVTPL. Gains or losses on such assets are recognised in profit or loss on an on-going basis.

In addition, the Bank may irrevocably designate a financial asset as at FVTPL that otherwise meets the requirements to be measured at amortised cost or at FVOCI if doing so eliminates or significantly reduces an accounting mismatch that would otherwise arise.

- Embedded derivatives

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

1. ACCOUNTING POLICIES

1.8. Financial assets

Business model assessment

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

– The strategy for the portfolio as communicated by management;
– How the performance of the portfolio is evaluated and reported to senior management;
– The risks that impact the performance of the business model, and how those risks are managed;
– How managers of the business are compensated (i.e. based on fair value of assets managed or on the contractual cash flows collected); and
– The frequency, value and timing of sales in prior periods, reasons for those sales, and expectations of future sales activity.

Financial assets that are held for trading or managed within a business model that is evaluated on a fair value basis are measured at FVTPL because the business objective is neither hold-to-collect contractual cash flows nor hold-to-collect-and-sell contractual cash flows.

Characteristics of the contractual cash flows

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

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

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

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

Reclassifications

Reclassifications of financial assets to alternative measurement categories, (e.g. from amortised cost to FVOCI), should be very infrequent, and will only occur if the Bank decides to make a fundamental change in its business model for managing a specific portfolio of financial assets.

1.9. Financial liabilities

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

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

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

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

The Bank derecognises a financial liability when its contractual obligation is discharged, cancelled or expired. Any gain or loss on the extinguishment or re-measurement of a financial liability is recognised in the income statement. See accounting policy note 1.12 Derecognition.

1. ACCOUNTING POLICIES

1.10. Determination of fair value of financial instruments

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

Financial instruments are initially recognised at fair value and, with the exception of financial assets at fair value through profit or loss, the initial carrying amount is adjusted for direct and incremental transaction costs. In the normal course of business, the fair value on initial recognition is the transaction price (fair value of consideration given or received). If the Bank determines that the fair value at initial recognition differs from the transaction price and the fair value is determined by a quoted price in an active market for the same financial instrument, or by a valuation technique which uses only observable market inputs, the difference between the fair value at initial recognition and the transaction price is recognised as a gain or loss. If the fair value is calculated by a valuation technique that features significant market inputs that are not observable, the difference between the fair value at initial recognition and the transaction price is deferred.

Subsequently, the difference is recognised in the income statement on an appropriate basis over the life of the financial instrument, but no later than when the valuation is supported by wholly observable inputs; the transaction matures; or is closed out.

Subsequent to initial recognition, the methods used to determine the fair value of financial instruments include quoted prices in active markets where those prices are considered to represent actual and regularly occurring market transactions. Where quoted prices are not available or are unreliable because of market inactivity, fair values are determined using valuation techniques. These valuation techniques maximise the use of relevant observable inputs and minimise the use of unobservable inputs.

The valuation techniques used incorporate the factors that market participants would take into account in pricing a transaction. Valuation techniques include the use of recent orderly transactions between market participants, reference to other similar instruments, option pricing models, discounted cash flow analysis and other valuation techniques commonly used by market participants.

Quoted prices in active markets

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

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

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

Valuation techniques

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

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.

1. ACCOUNTING POLICIES

1.10. Determination of fair value of financial instruments (continued)

Valuation techniques (continued)

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

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

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

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

Transfers between levels of the fair value hierarchy

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

1.11. Derivatives and hedge accounting

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

Derivatives

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

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

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

Hedging

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

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

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

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

1. ACCOUNTING POLICIES

1.11. Derivatives and hedge accounting (continued)

Hedging (continued)

The Bank discontinues hedge accounting when:

a. it is determined that a derivative is not, or has ceased to be, highly effective as a hedge;
b. the derivative expires, or is sold, terminated, or exercised;
c. the hedged item matures or is sold or repaid; or
d. a forecast transaction is no longer deemed probable.

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

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

The Bank applies the IBOR reform Phase 1 reliefs to hedging relationships directly affected by IBOR reform during the period before the replacement of an existing interest rate benchmark with an alternative risk-free rate ('RFR'). A hedging relationship is affected if IBOR reform gives rise to uncertainties about the timing and/or amount of benchmark-based cash flows of the hedged item or the hedging instrument. The reliefs require that for the purpose of determining whether a forecast transaction is highly probable, it is assumed that the IBOR on which the hedged cash flows are based is not altered as a result of IBOR reform.

IBOR reform Phase 1 requires that for hedging relationships affected by IBOR reform, the Bank must assume that for the purpose of assessing expected future hedge effectiveness, the interest rate is not altered as a result of IBOR reform. Also, the Bank is not required to discontinue the hedging relationship if the results of the assessment of retrospective hedge effectiveness fall outside the range of 80% to 125%, although any hedge ineffectiveness must be recognised in profit or loss, as normal.

The reliefs cease to apply once certain conditions are met. These include when the uncertainty arising from IBOR reform is no longer present with respect to the timing and amount of the benchmark-based cash flows of the hedged item, if the hedging relationship is discontinued or once amounts in the cash flow hedge reserve have been released.

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. If the hedged item is sold or repaid, the unamortised fair value adjustment is recognised immediately in the income statement.

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.

1.12. Derecognition

Financial assets

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

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

1. ACCOUNTING POLICIES
1.12. Derecognition (continued)
Financial assets (continued)
Where the Bank enters into transactions whereby it transfers assets recognised on its statement of financial position, but retains either all or substantially all of the risks and rewards of the transferred assets or a portion of them, the transferred assets are not derecognised. Examples of such transactions are securities lending and sale-and-repurchase transactions.

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

In transactions where the Bank retains the obligation to service the transferred financial asset for a fee. The transferred asset is derecognised if it meets the derecognition criteria. An asset or liability is recognised for the servicing contract if the servicing fee is more than adequate or is less than adequate for performing the servicing. The write-off of a financial asset constitutes a derecognition event. Where a financial asset is partially written-off, and the portion written-off comprises specifically identified cash flows, this will constitute a derecognition event for that part written-off.

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

– Financial assets at amortised cost; and
– Loan commitments issued.

ECLs are the weighted average of credit losses. These are an estimate of credit losses over the life of a financial instrument. When measuring ECLs, the Bank takes into account:

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

The amount of ECLs recognised as a loss allowance depends on the extent of credit deterioration since initial recognition. There are two measurement bases:
– 12-month ECLs (Stage 1), which applies to all items as long as there is no significant deterioration in credit quality since initial recognition; and
– Lifetime ECLs (Stages 2 and 3), which applies when a significant increase in credit risk has occurred on an individual or collective basis.

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

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

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

A financial asset can only originate in either Stage 1 or as POCI. The ECL held against an asset depends on a number of factors, one of which is its stage allocation. Assets allocated to Stage 2 and Stage 3 have lifetime ECLs. Collateral and other credit enhancements are not considered as part of stage allocation. Collateral is reflected in the Bank's LGD models.

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

POCIs are financial assets originated credit-impaired where the difference between the discounted contractual cash flows and the fair value at origination is greater than or equal to 5%.

The Bank uses an appropriate discount rate for measuring ECL in the case of POCIs which is the credit-adjusted EIR. This rate is used to discount the expected cash flows of such assets to fair value on initial recognition.

1. ACCOUNTING POLICIES

1.13. Impairment of financial assets

Purchased or originated credit impaired

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

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

Modification

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

A modification refers to either:

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

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

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

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

Where renegotiation of the terms of a financial asset leads to a customer granting equity to the Bank in exchange for any loan balance outstanding, the new instrument is recognised at fair value with any difference to the loan carrying amount recognised in the income statement.

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

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

Collateralised financial assets - Repossessions

The ECL calculation for a collateralised financial asset reflects the cash flows that may result from foreclosure, costs for obtaining and settling the collateral, and whether or not foreclosure is probable.

For loans which are credit-impaired, the Bank may repossess collateral previously pledged as security in order to achieve an orderly realisation of the loan. The Bank will then offer this repossessed collateral for sale. However, if the Bank believes the proceeds of the sale will comprise only part of the recoverable amount of the loan with the customer remaining liable for any outstanding balance, the loan continues to be recognised and the repossessed asset is not recognised. However, if the Bank believes that the sale proceeds of the asset will comprise all or substantially all of the recoverable amount of the loan, the loan is derecognised and the acquired asset is accounted for in accordance with the applicable accounting standard. Any further impairment of the repossessed asset is treated as an impairment of that asset and not as a credit impairment of the original loan.

1. ACCOUNTING POLICIES

1.13. Impairment of financial assets

Write-offs and debt forgiveness

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

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

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

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

1.14. Collateral

The Bank obtains collateral in respect of customer advances where this is considered appropriate. The collateral normally takes the form of a lien over the customer's assets and gives the Bank a claim on these assets for both existing and future customer liabilities. The collateral is, in general, not recorded on the statement of financial position.

1.15. Non-current assets held for sale

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

On initial classification as held for sale, generally, non-current assets are measured at the lower of previous carrying amount and fair value less costs to sell with any adjustments taken to the income statement. The same applies to gains and losses on subsequent re-measurement. However, financial assets within the scope of IFRS 9 continue to be measured in accordance with that standard.

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

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

1.16. 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. These are reported within Provisions for liabilities and commitments in the statement of financial position.

Legal claims and other contingencies

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

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

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

1. ACCOUNTING POLICIES

1.17. Shareholders' equity

Issued financial instruments, or their components, are classified as equity where they meet the definition of equity and confer on the holder a residual interest in the assets of the Bank.

On extinguishment of equity instruments, gains or losses arising are recognised net of tax directly in the statement of changes in equity.

Share capital

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

Share issue costs

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

Dividends and distributions

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank's shareholders, or in the case of the interim dividend when it has been approved for payment by the Board of Directors. The interim dividend may be cancelled at any time prior to the actual payment.

Capital reserves

Capital reserves represent cash contribution from AIB.

Revenue reserves

Revenue reserves represent retained earnings of the Bank. They also include amounts arising from the capital reduction undertaken by the Bank in June 2019.

1.18. 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.

1.19. Prospective accounting changes

The following amendments to existing standards which have been approved by the IASB, but not early adopted by the Bank, will impact the Bank's financial reporting in future periods. The Bank will consider the impact of these amendments as the situation requires. The amendments which are more relevant to the Bank are detailed below.

Interest Rate Benchmark Reform - Phase 2 Amendments to IFRS 9, IAS 39, IFRS 4 and IFRS 16

In August 2020, the IASB issued Interest Rate Benchmark Reform - Phase 2 Amendments to IFRS 9, IAS 39, IFRS 4 and IFRS 16 (IBOR reform Phase 2), to address the accounting issues which arise upon the replacement of an Interbank offered rate (IBOR) with a Risk Free Rate (RFR).

The Bank's primary exposure to impacted benchmark rates is EURIBOR which has an amended calculation methodology and is now considered Benchmark Regulation compliant, and does not expect Phase 2 will result in an impact on its financial statements.

Effective date: Annual reporting periods beginning on or after 1 January 2021.

IFRS 9 Financial Instruments - Fees in the '10 per cent' test for derecognition of financial liabilities

As part of its 2018 - 2020 Annual Improvements to IFRS standards process, the IASB issued an amendment to IFRS 9. The amendment clarifies the fees that an entity includes when it applies the 10% test in assessing whether to derecognise a financial liability. These fees include only those paid or received between the borrower and the lender, including fees paid or received by either the borrower or lender on the other's behalf.

The Bank will apply the amendments to financial liabilities that are modified or exchanged on or after the beginning of the annual period in which it will first apply the amendment and does not expect this will result in a significant impact on its financial statements.

Effective date: Annual reporting periods beginning on or after 1 January 2022.

Other

The IASB has published a number of other minor amendments to IFRSs through both standalone amendments and through the Annual Improvements to IFRS Standards 2018 - 2020 cycle. None of the other amendments are expected to have a significant impact on reported results or disclosures.

2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of financial statements requires management to make judgements, estimates and assumptions that affect the application of policies and reported amounts of certain assets, liabilities, revenues and expenses, and disclosures of contingent assets and liabilities. The estimates and assumptions are based on historical experience and various other factors that are believed to be reasonable under the circumstances. Since management judgement involves making estimates concerning the likelihood of future events, the actual results could differ from those estimates. The accounting policies that are deemed critical to the Bank's results and financial position, in terms of the materiality of the items to which the policy is applied and the estimates that have a significant impact on the financial statements are set out in this section. In addition, estimates with a significant risk of material adjustment in the next year are also discussed.

Significant judgements

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

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

Impairment of financial assets

The Bank's accounting policy for impairment of financial assets is set out in accounting policy 1.13 in note 1. The ECL allowance for financial assets at 31 December 2020 represent management's best estimate of the expected credit losses on various portfolios at the reporting date.

The calculation of the ECL allowance is complex and therefore, an entity must consider large amounts of information in their determination. This process requires significant use of a number of accounting judgements, estimates and assumptions, some of which, by their nature, are highly subjective and very sensitive to risk factors such as changes to economic conditions. This is particularly amplified at 31 December 2020 given the COVID-19 pandemic. Changes in the ECL allowance can materially affect net income.

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

– *determining the criteria for a significant increase in credit risk and for being classified as credit impaired;*
– *definition of default;*
– *choosing the appropriate models and assumptions for measuring ECL, e.g. PD, LGD and EAD and the parameters to be included within the models;*
– *determining the life of a financial instrument and therefore, the period over which to measure ECL;*
– *establishing the number and relative weightings for forward looking scenarios for each asset class and ECL;*
– *determining post-model adjustments using an appropriate methodology; and*
– *assessing the impact of forbearance strategies on cash flows and therefore, the ECL allowance for restructured loans.*

The management process for the calculation of the ECL allowance is underpinned by independent tiers of review. The Bank assesses and approves the ECL allowance and its adequacy on an annual basis. The ECL allowance is, in turn, reviewed and approved by the AIB Group Credit Committee on a quarterly basis with final AIB Group levels being approved by the AIB Board Audit Committee. Further detail on the ECL governance process is set out on page 29.

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

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

The significant accounting judgements noted above and made by Management in estimating the ECL allowance are outlined on pages 19 to 29 in the Risk management section of this report.

Provisions for liabilities and commitments

The Bank's accounting policy for provisions for liabilities and commitments is set out in note 1.15. 'Non-credit risk provisions'.

The Bank recognises liabilities where it has present legal or constructive obligations as a result of past events and it is more likely than not that these obligations will result in an outflow of resources to settle the obligations and the amount can be reliably estimated. Details of the Bank's liabilities and commitments are shown in note 24 to the financial statements

2. CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES
Provisions for liabilities and commitments (continued)

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

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

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

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

ECL allowances
ECL allowances at 31 December 2020 amounted to €320m (2019: €210m). As noted above, there are significant judgements involved in estimating ECL allowances, particularly given the COVID-19 pandemic. Certain of these estimates together with estimates which do not involve accounting judgements may have a significant risk of material adjustment to carrying amounts of assets within the next financial year.

In particular, discounted cash-flows ('DCFs') are the most significant input to the ECL calculation for Stage 3 credit-impaired obligors where the gross credit exposure is ≥ €1 million. Collateral valuations and the estimated time to realisation of collateral is a key component of the DCF model. The DCF assessment produces a base case ECL which is then adjusted to incorporate the impact of multiple scenarios on the base ECL. The size of the adjustment must consider all relevant and supportable information, including but not limited to, historical data analysis, predictive modelling and management judgement.

The macroeconomic variables used in models to calculate ECL allowance are based on assumptions, forecasts and estimates against a backdrop of the COVID-19 pandemic. These are subject to change as the COVID-19/economic landscape changes. Accordingly, developments with regard to the pandemic and changes in local and international factors could have a material bearing on the ECL allowance within the next financial year. The Bank's sensitivity to a range of macroeconomic factors under (i) base forecast; (ii) upside; and (iii) downside scenarios is set out on pages 23 to 27 of the Risk Management section of this report.

Provisions for liabilities and commitments
Provisions for liabilities and commitments are set out in note 24 to the financial statements and their recognition involves a significant degree of estimation. The overall provision amounting to €76m comprising: €68m in respect of the FSPO decision relating to tracker mortgage customers and €8m residual provision for tracker mortgages in respect of previous settlements and related matters.

Note 24 sets out the background and the current position as regards the FSPO decision regarding a tracker complaint and the level of provisions that were set aside. Notwithstanding the near completion of payments to customers based on the FSPO decision, the level of provision required for other costs, including tax liabilities arising that the Bank will be required to discharge on behalf of impacted customers, has been assessed at €68 million. These issues are subject to uncertainty with a range of outcomes possible with the final outcome being higher or lower depending on finalisation of such issues.

As detailed in note 24, AIB was advised in 2018 by the CBI of the commencement of investigations as part of an administrative sanctions procedure in connection with the Tracker Mortgage Examination. The Bank has not created a provision for any administrative sanction as any such charge will be borne by the Bank's parent.

Other than the above, there is no individually significant provision that is expected to result in a material adjustment in the next financial year.

3. INTEREST INCOME CALCULATED USING THE EFFECTIVE INTEREST METHOD

	2020 €m	2019 €m
Interest on loans and advances to customers at amortised cost	**411**	413
Interest earned from AIB	**21**	22
	432	435

Interest earned from AIB is €21m (2019: €22m) and relates to covered securities hedges (bond swaps).

4. INTEREST AND SIMILAR EXPENSE

	2020 €m	2019 €m
Interest on debt securities in issue	**29**	33
Interest payable to AIB	**43**	91
	72	124

Included in the interest payable to AIB is interest payable on funding charge and other additional funding costs of €33m (2019: €83m), and also interest payable on loan portfolio swaps of €10m (2019: €8m).

5. NET FEE INCOME

	2020 €m	2019 €m
Fees receivable from Group undertaking	**—**	197
	—	197

The pricing arrangements between AIB and the Bank reflect revised OECD guidelines on transfer pricing, which are the internationally accepted principles in this area, and which take account of the functions, risks and assets involved. For 2020 it required a net payment by the Bank to AIB (see note 9: Administrative expenses). For 2019 this required a net payment by AIB to the Bank of €197m.

6. NET GAIN ON OTHER FINANCIAL ASSETS MEASURED AT FVTPL

	2020 €m	2019 €m
Loans and advances to customers	**4**	2
	4	2

7. NET GAIN/(LOSS) ON DERECOGNITION OF FINANCIAL ASSETS MEASURED AT AMORTISED COST

				2020
	Carrying value at derecognition	Gain on derecognition[1]	Loss on derecognition[1]	Net gain on derecognition
	€m	€m	€m	€m
Loans and advances to customers	—	3	—	3
	—	3	—	3

				2019
	Carrying value at derecognition	Gain on derecognition[1]	Loss on derecognition[1]	Net loss on derecognition
	€m	€m	€m	€m
Loans and advances to customers	299	47	(64)	(17)
	299	47	(64)	(17)

[1] The gain/loss on derecognition has been based on the proceeds of sale, net of costs, computed at a customer connection level.

Gain on derecognition in 2020 arose from final settlement relating to loans sold in 2019. In 2019 Loans and advances to customers were derecognised due mainly to the sale of distressed loan portfolios.

8. OTHER OPERATING INCOME

	2020	2019
	€m	€m
Miscellaneous operating income	2	2
	2	2

Other operating income of €2m in 2020 (2019: €2m) relates to additional income recognised when out of course lodgements are received on loans that required a fair value adjustment on initial recognition.

9. ADMINISTRATIVE EXPENSES

	2020	2019
	€m	€m
Amounts payable to AIB	225	149
Other administrative expenses	8	244
	233	393

Amounts payable to AIB are determined by the pricing agreement, based on the Transactional Net Margin Method, updated in 2020 to reflect revised OECD guidelines on transfer pricing, which are the internationally accepted principles in this area, and which take account of the functions, risks and assets involved. For 2020 this required a net payment of €225m to AIB (2019: €149m payable offset by income received from AIB of €197m as shown in note 5: Net fee income).

Other administrative expenses consists of professional fees €1m (2019: €1m), statutory payments (regulatory charges/ levies) €9m (2019: €8m), and a provisions for liabilities and commitments release of €2m (2019: €235m charge). See note 24. Provisions for liabilities and commitments for further information.

For the financial year ended 31 December 2020 the monthly average number of employees was 2 (2019: 2). As at 31 December 2020, the Bank had 2 employees (2019: 2).

9. ADMINISTRATIVE EXPENSES

In addition a small number of AIB employees maintain a parallel employment relationship with the Bank, in order to facilitate delivery of outsourced service activities under the Outsourcing and Agency Agreement with AIB. These parallel employments are unremunerated. These employees of AIB in the Republic of Ireland have a primary employment relationship with AIB, which maintains day-to-day control over them and remains responsible for the payment of their remuneration as well as accounting for tax and other payroll deductions.

Personnel expenses

	2020	2019
	€m	€m
Wages and salaries	**0.2**	0.2
	0.2	0.2

Personnel expenses capitalised during the financial year were nil (2019: nil). Personnel expenses borne by AIB are allocated to the Bank under an Outsourcing and Agency Agreement.

Director's remuneration

	2020	2019
	€'000	€'000
Simon Ball	**25**	20
Yvonne Hill	**24**	—
Paul Owens	**24**	—
Catherine Woods[1]	**—**	13
	73	33

(1) Catherine Woods resigned as a Director and Chair of the Audit Committee on 31 December 2019

No additional remuneration has been paid to any individuals employed directly by AIB for roles discharged as directors of the Bank. The Non-Executive Directors' fees are non-pensionable.

The Directors do not participate in share option plans, therefore there were no gains on exercise of share options during the financial year in accordance with Section 305(1) of the Companies Act 2014.

There were no amounts paid (2019: nil) to persons connected with a Director in accordance with Section 306(1) of the Companies Act 2014.

10. AUDITOR'S FEES

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

	2020	2019
	€'000	€'000
Auditor's fees (excluding VAT):		
Statutory audit of entity financial statements	**130**	110
Other assurance services	**—**	18
Other non-audit services	**—**	—
	130	128

11. NET CREDIT IMPAIRMENT CHARGE

	2020 Measured at amortised cost €m	2019 Measured at amortised cost €m
Net measurement of loss allowance:		
Loans and advances to customers	**(128)**	(16)
Credit impairment charge	**(128)**	(16)
Recoveries of amounts previously written-off	**15**	19
Net credit impairment (charge)/writeback	**(113)**	3

12. TAXATION

	2020 €m	2019 €m
Current taxation		
Current tax on income for the year	**(2)**	(12)
	(2)	(12)
Deferred taxation		
Origination and reversal of temporary differences	**(1)**	(1)
Total tax charge for the year	**(3)**	(13)
Effective income tax rate	**12.5 %**	12.5 %

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

	2020		2019	
	€m	%	€m	%
Operating profit before taxation	**23**		105	
Corporation tax charge (12.5%)	**(3)**	**12.5**	(13)	12.5
Effects of:				
Income taxed at higher tax rates	**—**	**—**	—	—
Tax charge	**(3)**	**12.5**	(13)	12.5

13. NON-CURRENT ASSETS HELD FOR SALE

	2020 €m	2019 €m
Repossessed assets	**2**	3
	2	3

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

14. DERIVATIVE FINANCIAL INSTRUMENTS

Set out below are details on fair values and derivative information for the 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. AIB is the counterparty to all derivative contracts noted below.

			2020			2019
	Contract/ Notional Amount	**Fair Value Asset**	**Fair Value Liability**	Contract/ Notional Amount	Fair Value Asset	Fair Value Liability
	€m	**€m**	**€m**	€m	€m	€m
Derivatives classified as trading						
Interest rate swaps	**17,953**	**1**	**—**	18,229	—	(1)
Derivatives classified as hedging (Debt Securities)						
Interest rate swaps	**2,275**	**51**	**—**	3,025	64	—
Total derivatives	**20,228**	**52**	**—**	21,254	64	(1)

In relation to Debt Securities there was a nil net trading gain (2019: nil).

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

	Residual maturity 2020				Residual maturity 2019			
	Less than 1 year	**1 to 5 years**	**5 years +**	**Total**	Less than 1 year	1 to 5 years	5 years +	Total
Residual maturity	**€m**	**€m**	**€m**	**€m**	€m	€m	€m	€m
Notional principal amount	**18,453**	**1,750**	**25**	**20,228**	18,979	2,250	25	21,254
Positive fair value	**12**	**30**	**10**	**52**	6	34	24	64

14. DERIVATIVE FINANCIAL INSTRUMENTS

Nominal values and average interest rates by residual maturity

At 31 December 2020 and 2019, the Bank held the following hedging instruments of interest rate risk in fair value hedges:

	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years +	2020 Total
Fair value hedges - Interest rate swaps						
Liabilities						
Hedges of debt securities in issue						
Nominal principal amount (€m)	—	500	—	1,750	25	2,275
Average interest rate (%)	—	2.25	—	0.60	5.12	1.14

	Less than 1 month	1 to 3 months	3 months to 1 year	1 to 5 years	5 years +	2019 Total
Fair value hedges - Interest rate swaps						
Liabilities						
Hedges of debt securities in issue						
Nominal principal amount (€m)	—	—	750	2,250	25	3,025
Average interest rate (%)	—	—	0.63	1.10	5.12	1.01

Fair value hedges of interest rate risk

The tables below set out the amounts relating to items designated as (a) hedging instruments and (b) hedged items in fair value hedges of interest rate risk together with the related hedge ineffectiveness at 31 December 2020 and 2019:

		Carrying amount					2020
	Nominal	Assets	Liabilities	Line item in SOFP where the hedging instrument is included	Change in fair value used for calculating hedge ineffectiveness for the year	Hedge ineffectiveness recognised in the income statement	Line item in the income statement that includes hedge ineffectiveness
(a) Hedging instruments	€m	€m	€m		€m	€m	
Interest rate swaps hedging:							
Debt securities in issue	2,275	51	—	Derivative financial instruments	—	—	Net trading income[1]

[1] Net trading income is not disclosed in the income statement as it is below €1m.

14. DERIVATIVE FINANCIAL INSTRUMENTS

2020

(b) Hedged items	Carrying amount of hedged items recognised in the SOFP Assets €m	Liabilities €m	Accumulated amount of fair value hedge adjustments on the hedged items included in the carrying amount of the hedged item Assets €m	Liabilities €m	Line item in SOFP where hedging instrument is included	Change in value of hedged items used for calculating hedge ineffectiveness for the year €m	Accumulated amount of fair value hedge adjustments remaining in the SOFP for any hedged items that have ceased to be adjusted for hedging gains and losses €m
Interest rate swaps hedging							
Debt securities in issue	**—**	**(2,304)**	**—**	**(29)**	**Debt securities in issue**	**—**	**—**

2019

(a) Hedging instruments	Nominal €m	Carrying amount Assets €m	Carrying amount Liabilities €m	Line item in SOFP where the hedging instrument is included	Change in fair value used for calculating hedge ineffectiveness for the year €m	Hedge ineffectiveness recognised in the income statement €m	Line item in the income statement that includes hedge ineffectiveness
Interest rate swaps hedging							
Debt securities in issue	3,025	64	—	Derivative financial instruments	—	—	Net trading income

2019

(b) Hedged items	Carrying amount of hedged items recognised in the SOFP Assets €m	Liabilities €m	Accumulated amount of fair value hedge adjustments on the hedged items included in the carrying amount of the hedged item Assets €m	Liabilities €m	Line item in SOFP where hedging instrument is included	Change in value of hedged items used for calculating hedge ineffectiveness for the year €m	Accumulated amount of fair value hedge adjustments remaining in the SOFP for any hedged items that have ceased to be adjusted for hedging gains and losses €m
Interest rate swaps hedging:							
Debt securities in issue	—	(3,065)	—	(40)	Debt securities in issue	—	—

15. LOANS AND ADVANCES TO BANKS

	2020 €m	2019 €m
Funds placed with banks	**20**	20
Funds placed with Group undertaking	**50**	65
	70	85
Analysed by remaining maturity:		
3 months or less	**70**	85

Funds placed with Group undertaking were assessed for an ECL at 31 December 2020 and 2019. It was deemed to be immaterial on both dates.

The funds placed with banks of €20m (2019: €20m) are held by Barclays Bank Ireland, p.l.c. and represent the Cash substitution pool assets. Cash substitution pool assets are an Asset Covered Securities Act concept whereby certain non-mortgage assets can be held as part of the Cover Assets Pool in addition to the mortgage credit assets. The funds placed with Group undertaking of €50m (2019: €65m) are placed with AIB as collateral for derivatives (note 14).

The Barclays Bank Ireland, p.l.c. credit rating at 31 December 2020 with Standard & Poor's was A. The Bank's covered bond program credit rating at 31 December 2020 with Standard & Poor's was AAA.

16. LOANS AND ADVANCES TO CUSTOMERS

	2020 €m	2019 €m
Analysed by remaining maturity:		
Repayable on Demand	**451**	498
3 months or less	**4**	4
1 year or less but over 3 months	**17**	20
5 years or less but over 1 year	**496**	476
Over 5 years	**16,517**	16,746
Gross carrying amount	**17,485**	17,744
Expected credit loss allowance	**(320)**	(210)
	17,165	17,534

For details of credit quality of loans and advances to customers, including forbearance, refer to the 'Risk management' section of this report.

ECL movement
The following table shows the movements on the ECL allowance on loans and advances to customers. Further information is disclosed in the 'Risk management' section of this report.

	31 December 2020 €m	31 December 2019 €m
Opening balance	**210**	314
Net remeasurement of loss allowance - customers	**128**	16
Changes in loss allowance due to write-offs	**(18)**	(51)
Changes in loss allowance due to disposals	**—**	(69)
At 31 December	**320**	210
Amounts include loss allowance on:		
Loans and advances to customers measured at amortised cost	**320**	210

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

Loans and advances 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.

17. OTHER ASSETS

	2020 €m	2019 €m
Accrued interest	29	30
Proceeds due from disposal of loan portfolio[1]	—	83
	29	113

[1]ECL is nil

18. DEFERRED TAXATION

	2020 €m	2019 €m
Deferred tax assets:		
Transition to IFRS 9	2	3
Total gross deferred tax assets	2	3
Deferred tax liabilities		
Total gross deferred tax liabilities	—	—
Net deferred tax assets	2	3

Analysis of movements in deferred taxation	2020 €m	2019 €m
At 1 January	3	4
Income statement (note 12)	(1)	(1)
At 31 December	2	3

The movement in deferred taxation of €1m during 2020 represents the amortisation of the deferred tax asset created on transition to IFRS 9 (2019: movement of €1m represents the amortisation of the deferred tax asset created on transition to IFRS 9). Deferred tax asset is expected to be utilised within 2 years (2019: 3 years).

19. DEPOSITS BY BANKS

	2020 €m	2019 €m
Allied Irish Banks, p.l.c.	4,914	6,492
	4,914	6,492

The Bank has a borrowing facility with its parent company, AIB, under which the parent company provides the balance of funding after the Bank has availed of other sources of funds.

20. CUSTOMER ACCOUNTS

	2020 €m	2019 €m
Current accounts	1	1
	1	1

21. DEBT SECURITIES IN ISSUE

	2020 €m	2019 €m
Mortgage covered securities in issue to external investors and internal issuances at carrying value:		
External investors	**2,275**	3,025
Allied Irish Banks, p.l.c.	**8,400**	6,400
	10,675	9,425
Analysed by remaining maturity:		
1 year or less but over 3 months	**1,150**	750
5 years or less but over 1 year	**5,750**	4,900
Greater than 5 years	**3,775**	3,775
Carrying value of debt securities[1]	**10,675**	9,425

[1] The fair value of hedged liability positions is disclosed in note 22. Other liabilities.

The Bank is an issuer of mortgage covered securities under the Asset Covered Securities Act, 2001 as amended by the Asset Covered Securities Amendment Act, 2007 (the "Act"). The Act requires that mortgage covered securities are secured by assets that are included in a Cover Assets Pool maintained by the issuer and that a register of mortgage covered securities business is kept.

At 31 December 2020, the Cover Assets Pool amounted to €15.34bn (2019: €14.59bn), comprising of €15.32bn (2019: €14.57bn) of mortgage credit assets (mortgage loan accounts) and €0.02bn (2019: €0.02bn) of substitution assets (cash on deposit with suitably rated credit institutions).

Section 40(2) of the Act requires that the following information be disclosed in respect of mortgage credit assets that are recorded in the register of mortgage covered securities business.

(a) Mortgaged properties and principal loan balances outstanding in the Cover Assets Pool

Total Loan Balances

From	To	**Total Loan Balances 2020 (1 & 2) €m**	**Number of Mortgaged Properties 2020**	Total Loan Balances 2019 (1 & 2) €m	Number of Mortgaged Properties 2019
€0	€100,000	**2,339**	**44,397**	2,219	42,322
€100,000	€200,000	**5,959**	**40,988**	5,671	39,025
€200,000	€500,000	**6,218**	**22,870**	5,908	21,779
Over €500,000		**808**	**1,140**	773	1,077
		15,324	**109,395**	14,571	104,203

[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 121,774 loan accounts (2019: 115,914) secured on 109,395 properties (2019: 104,203).

21. DEBT SECURITIES IN ISSUE

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

Geographical Area	Number of Mortgaged Properties	2020	Number of Mortgaged Properties	2019
Dublin	**29,260**	**27 %**	**27,973**	**27%**
Outside Dublin	**80,135**	**73 %**	**76,230**	**73%**
	109,395	**100 %**	**104,203**	**100%**

(c) Mortgage loan accounts in default in the Cover Assets Pool
As at 31 December 2020, there were no mortgage loan accounts (2019: 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 2020, no mortgage loan accounts (2019: nil) in the Cover Assets Pool had been in default with arrears greater than €1,000.

(e) Replacement of non-performing mortgage loan accounts from the Cover Assets Pool
During the financial year ended 31 December 2020, no non-performing mortgage loan accounts (2019: 4) 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 742 accounts (2019: 221) as at 31 December 2020 was €819,164 (2019: €175,208). €156,405 of this represented non-payment of interest (2019: €49,863). None of the accounts in question were written off as at 31 December 2020.

(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 2020 was €1,936m (2019: €1,961m), of which €1,569 (2019: €1,618m) represented repayment of principal and €367m (2019: €344m) 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 2020 there were no loan accounts (2019: nil) in the Cover Assets Pool that were secured on commercial properties.

22. OTHER LIABILITIES

	2020	2019
	€m	€m
Fair value of hedged liability positions	**29**	40
Other liabilities	**3**	1
	32	41

23. ACCRUALS AND DEFERRED INCOME

	2020	2019
	€m	€m
Interest payable on mortgage covered securities	**24**	24
Other accrued expense	**4**	4
	28	28

24. PROVISIONS FOR LIABILITIES AND COMMITMENTS

	2020	2019
	€m	€m
At 1 January	**236**	11
Amounts charged to income statement	**4**	235
Amounts written back to income statement	**(6)**	—
Provisions utilised	**(158)**	(10)
At 31 December	**76**	236

The total provisions for liabilities and commitments expected to be settled within one year amount to €76m (2019: €236m).

Provisions for customer redress and other costs

FSPO Decision: The provision at 31 December 2020 for customer redress and compensation and other related costs amounted to €68m (31 December 2019: €229m) in respect of certain mortgage customers – the '06-09 Terms & Conditions ('Ts&Cs') who never had a tracker' cohort.

Following a complaint to the FSPO by a customer from the '06-09 Ts&Cs who never had a tracker' cohort, the Group received a preliminary decision in January 2020 which found that the Bank had breached the terms of the customer's mortgage loan contract and directed it to remedy the matter in what the FSPO believed was a fair and proportionate manner. The Bank considered this preliminary decision and recorded a provision of €229m as at 31 December 2019 based on an initial assessment of the likelihood that the same remedy may be due to all customers in this cohort.

The Group subsequently received the FSPO's final decision and decided to accept the decision in full and furthermore decided to apply the remedy to all other customers within this cohort, with payments to customers commencing in July 2020. Following intervention by the Central Bank of Ireland, some of these customers were also deemed eligible for inclusion in the Tracker Mortgage Examination. This resulted in €13m of the original provision being reclassified accordingly.

The Bank continues to engage with stakeholders and a number of related issues also exist that have yet to be resolved. Notwithstanding the near completion of payments to customers based on the FSPO decision, the level of provision required for these other costs, including tax liabilities arising that the Bank will be required to discharge on behalf of impacted customers, has been assessed at €68m which resulted in a release of €4m in the year.

These issues are subject to uncertainty with a range of outcomes possible with the final outcome being higher or lower depending on finalisation of such issues.

Tracker Mortgage Examination: In respect of customer redress and compensation a provision of €4m is held at 31 December 2020 for identified impacted accounts under the Tracker Mortgage Examination and the ongoing appeals process. Provisions, including the €13m reclassified as noted earlier, amounting to €124m were created in the period 2015 to 2020 (€16m in 2020). Over €120m of these provisions have now been utilised (€16m in 2020).

The provision at 31 December 2020 for 'Other costs' amounted to €4m. Provisions amounting to €54m were created in the period 2015 to 2020 (€1m in 2020). Over €50m of these provisions have now been utilised (nil in 2020).

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

The Bank has not created a provision for any administrative sanction as any such charge will be borne by the Bank's parent, given that AIB has raised a provision in this regard in 2019.

25. SUBORDINATED LIABILITIES

	2020 €m	2019 €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, AIB on 13 February 2006. The Note has a fixed maturity date of 12 February 2031. Early repayment may occur at the option of the Bank with the prior consent of the Central Bank of Ireland on any interest payment date falling any time after five years and one day from the date of issuing the Note.

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 and is reflected in note 4 'Interest and similar expense'.

(b) €200,000,000 Subordinated Perpetual Capital Note – the loan to which this note relates was received from AIB on 13 February 2006. The Note is undated and has no final maturity date but may be redeemed at the option of the Bank with the prior consent of the Central Bank at any time after the fifth anniversary of its issue.

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 and is reflected in note 4 'Interest and similar expense'.

The two capital notes are 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 the Bank and creditors of the Bank whose claims are subordinated to the claims of depositors and other unsubordinated creditors of the Bank but excluding pari passu Subordinated Creditors and those creditors of the Bank whose claims rank or are expressed to rank junior to the claims of AIB.

26. ISSUED SHARE CAPITAL PRESENTED AS EQUITY

		2020		2019
	Number of shares €m	**€m**	Number of shares €m	€m
Authorised:				
Ordinary share capital				
Ordinary shares of €0.25 each	**3,000**	**750**	3,000	750
Issued and fully paid up:				
Ordinary share capital				
Ordinary shares of €0.25 each	**1,745**	**436**	1,745	436

Movements in Issued share capital	2020 €m	2019 €m
At 1 January	**436**	1,745
Capital reduction	**—**	(1,309)
At 31 December	**436**	436

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.

27. CAPITAL RESERVES

	2020 €m	2019 €m
At 1 January	**580**	580
At 31 December	**580**	580

Capital reserves represent cash contribution from AIB.

28. CAPITAL MANAGEMENT

Capital regulation
The Capital Requirements Directive IV ('CRD IV'), which came into force on 1 January 2014, consists of the Capital Requirements Regulation ('CRR') and the Capital Requirements Directive ('CRD'), and is designed to strengthen the regulation of the banking sector and to implement the Basel III agreement in the EU legal framework. CRD IV measures include:
– a single set of harmonised prudential rules which enhanced requirements for quality and quantity of capital; and
– harmonising the deductions from own funds in order to determine the amount of regulatory capital that is prudent to recognise for regulatory purposes.

There are transitional arrangements for mitigating the impact of the introduction of IFRS 9 on capital as per Regulation (EU) 2017/2395 of the European Parliament and of the Council.

In addition, a suite of measures have been introduced to support the financial sector through the current COVID-19 pandemic. These include the reduction in the CCyB to zero by the CBI. Other measures include amendments to the transitional rules for IFRS 9 in respect of COVID-19 related losses and the accelerated introduction of rules to allow the inclusion of prudentially valued software assets in capital.

The Bank commenced reporting to its regulator under the transitional CRD IV rules during 2014. The transitional capital ratios presented on page 8 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 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.

29. STATEMENT OF CASH FLOWS
Analysis of cash and cash equivalents

	2020 €m	2019 €m
Loans and advances to banks (note 15)	**70**	85
	70	85

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

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

31. CONTINGENT LIABILITIES AND COMMITMENTS
In the normal course of business, the Bank is a party to financial instruments with off-balance sheet risk to meet the financing needs of customers. These instruments involve, to varying degrees, elements of credit risk which are not reflected in the consolidated statement of financial position. Credit risk is defined as the possibility of sustaining a loss because the other party to a financial instrument fails to perform in accordance with the terms of the contract.

The Bank’s maximum exposure to credit loss under contingent liabilities and commitments to extend credit, in the event of non-performance by the other party where all counterclaims, collateral or security prove valueless, is represented by the contractual amounts of those instruments.

31. CONTINGENT LIABILITIES AND COMMITMENTS

The Bank uses the same credit control and risk management policies in undertaking off-balance sheet commitments as it does for 'on- balance sheet lending'. Litigation has been served on the Bank by customers that are pursuing claims in relation to tracker mortgages. Customers have also lodged complaints to the FSPO in relation to tracker mortgages issues.

At 31 December 2020 the Bank had €559m (2019: €595m) of approved mortgage loan applications that had not been drawn down as at the year end.

Loan commitments are classified and measured in accordance with IFRS 9. The Bank's accounting policy for the recognition of ECL allowances on loan commitments is set out in accounting policy number 1.13 Impairment of financial assets.

The loan commitments were assessed for an ECL at 31 December 2020, it was determined that the ECL was immaterial (2019: immaterial).

Further claims may also be served in the future in relation to tracker mortgages. The Bank may also receive further decisions by the FSPO in relation to complaints concerning tracker mortgages.

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

32. CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

Financial assets and financial liabilities are measured on an ongoing basis either at fair value or at amortised cost. The accounting policy for financial assets in note 1.8 and financial liabilities in note 1.9, describes how the classes of financial instruments are measured, and how income and expenses, including fair value gains and losses, are recognised.

The following table analyses at 31 December 2020 and 2019 the carrying amounts of the financial assets and financial liabilities by measurement category as defined in IFRS 9 Financial Instruments and by statement of financial position heading.

				2020
	At fair value through profit or loss	At amortised cost		Total
	Mandatorily	Loans and advances	Other	
	€m	€m	€m	€m
Financial assets				
Derivative financial instruments	52	—	—	52
Loans and advances to banks	—	70	—	70
Loans and advances to customers	—	17,165	—	17,165
Other financial assets	—	—	29	29
	52	17,235	29	17,316
Financial liabilities				
Deposits by banks	—	—	4,914	4,914
Customer accounts	—	—	1	1
Derivative financial instruments	—	—	—	—
Debt securities in issue	—	—	10,675	10,675
Subordinated liabilities	—	—	300	300
Other financial liabilities	—	—	31	31
	—	—	15,921	15,921

32. CLASSIFICATION AND MEASUREMENT OF FINANCIAL ASSETS AND FINANCIAL LIABILITIES

				2019
	At fair value through profit or loss	At amortised cost		Total
	Mandatorily	Loans and advances	Other	
	€m	€m	€m	€m
Financial assets				
Derivative financial instruments	64	—	—	64
Loans and advances to banks	—	85	—	85
Loans and advances to customers	—	17,534	—	17,534
Other financial assets	—	—	113	113
	64	17,619	113	17,796
Financial liabilities				
Deposits by banks	—	—	6,492	6,492
Customer accounts	—	—	1	1
Derivative financial instruments	1	—	—	1
Debt securities in issue	—	—	9,425	9,425
Subordinated liabilities	—	—	300	300
Other financial liabilities*	—	—	29	29
	1	—	16,247	16,248

*Restated for 2019 from €28m to €29m.

33. 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 Bank's accounting policy for the determination of fair value of financial instruments is set out in accounting policy number 1.10.

The valuation of financial instruments, including loans and advances, involves the application of judgement and estimation. Market and credit risks are key assumptions in the estimation of the fair value of loans and advances. The Bank has estimated the fair value of its loans to customers taking into account market risk and the changes in credit quality of its borrowers.

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

Level 1 – financial assets and liabilities measured using quoted market prices from an active market (unadjusted).
Level 2 – financial assets and liabilities measured using valuation techniques which use quoted market prices from an active market or measured using quoted market prices unadjusted from an inactive market.
Level 3 – financial assets and liabilities measured using valuation techniques which use unobservable inputs.

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

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

Readers of these financial statements are advised to use caution when using the data in the following table to evaluate the Bank's financial position or to make comparisons with other institutions. Fair value information is not provided for items that do not meet the definition of a financial instrument such as shareholders' equity. These items are material and accordingly, the fair value information presented does not purport to represent, nor should it be construed to represent, the underlying value of the Bank as a going concern at 31 December 2020.

33. FAIR VALUE OF FINANCIAL INSTRUMENTS

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.

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

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

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

The fair value of variable rate mortgage products including tracker mortgages is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in the portfolio. For fixed rate mortgages, the fair value is calculated by discounting expected cash flows using discount rates that reflect the interest rate risk in that portfolio. For the overall loan portfolio, an adjustment is made for credit risk which at 31 December 2020 took account of the Bank's' expectations on credit losses over the life of the loans.

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

Debt securities in issue
The estimated fair value of debt securities in issue, is based on quoted prices were available, or where these are unavailable, are estimated using valuation techniques using observable market data for similar instruments. Where there is no market data for a directly comparable instrument, management judgement, on an appropriate credit spread to similar or related instruments with market data available, is used within the valuation technique. 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 Bank recognises transfers between levels of the fair value hierarchy at the end of the reporting period during which the change occurred.

33. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following table sets out the carrying value of financial instruments across the three levels of the fair value hierarchy at 31 December 2020 and 2019:

					2020
	Carrying amount	Fair value			
		Fair value hierarchy			
		Level 1	Level 2	Level 3	Total
	€m	€m	€m	€m	€m
Financial assets measured at fair value					
Derivative financial instruments:					
Interest rate swaps	52	—	52	—	52
Financial assets not measured at fair value					
Loans and advances to banks	70	—	—	70	70
Loans and advances to customers	17,165	—	—	17,639	17,639
Other financial assets	29	—	—	29	29
	17,264	—	—	17,738	17,738
Financial liabilities not measured at fair value					
Deposits by banks	4,914	—	—	4,914	4,914
Customer accounts	1	—	—	1	1
Debt securities in issue	10,675	11,210	—	—	11,210
Subordinated liabilities	300	—	194	—	194
Other financial liabilities	31	—	—	31	31
	15,921	11,210	194	4,946	16,350

33. FAIR VALUE OF FINANCIAL INSTRUMENTS

	Carrying amount	Fair value			2019
		Fair value hierarchy			
		Level 1	Level 2	Level 3	Total
	€m	€m	€m	€m	€m
Financial assets measured at fair value					
Derivative financial instruments:					
Interest rate swaps	64	—	64	—	64
Financial assets not measured at fair value					
Loans and advances to banks	85	—	—	85	85
Loans and advances to customers	17,534	—	—	17,634	17,634
Other financial assets	113	—	—	113	113
	17,732	—	—	17,832	17,832
Financial liabilities measured at fair value					
Derivative financial instruments:					
Interest rate swaps	1	—	1	—	1
Financial liabilities not measured at fair value					
Deposits by banks	6,492	—	—	6,492	6,492
Customer accounts	1	—	—	1	1
Debt securities in issue	9,425	9,708	—	—	9,708
Subordinated liabilities	300	—	221	—	221
Other financial liabilities*	29	—	—	29	29
	16,247	9,708	221	6,522	16,451

*Restated for 2019 from €28m to €29m.

Significant transfers between Level 1 and Level 2 of the fair value hierarchy

There were no transfers between Level 1 and Level 2 of the fair value hierarchy for the years ended 31 December 2020 and 2019.

34. RELATED PARTY TRANSACTIONS

(a) Transactions with AIB

The Bank is a subsidiary of AIB. Banking transactions are entered into between the 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 financial statements. 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. In addition, the Bank has a pricing agreement with AIB updated in 2020 to reflect revised OECD guidelines on transfer pricing, which are the internationally accepted principles in this area, and which take account of the functions, risks and assets involved (see note 9: Administrative expenses). The Bank is also party to the Mortgage-Backed Promissory Note Framework Agreements with the CBI, however this type of funding has not been utilised since 2011.

	2020	2019
	€m	€m
Included in the statement of financial position		
Loans and advances to banks	**50**	65
Deposits by banks	**4,914**	6,492
Derivative financial instruments		
Interest rate swaps		
Assets (Fair value)	**52**	64
Liabilities (Fair value)	**—**	(1)
Included in the income statement		
Interest income	**21**	22
Interest expense	**(43)**	(91)
Net fee income	**—**	197
Administrative expenses	**(225)**	(149)

(b) IAS 24 Related Party Disclosures

The following disclosures are made in accordance with the provisions of IAS 24 Related Party Disclosures. Under IAS 24, Key Management Personnel ('KMP') are defined as comprising Executive, Non-Executive Directors and Senior Executive Officers. As at 31 December 2020 the Bank has 8 KMP (2019: 7 KMP).

(i) Compensation of Key Management Personnel ('KMP')

Compensation of KMP, namely Executive and Non-Executive Directors and Senior Executive Officers, in office during the year is paid by AIB and allocated to the Bank under the Outsourcing and Agency Agreement.

	2020	2019
	€'000	€'000
Short-term compensation*	**73**	33
Post-employment benefits	**—**	—
Termination benefits	**—**	—
	73	33

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

The figures shown include the figures separately reported in respect of Directors' remuneration in note 9. Administrative expenses.

34. RELATED PARTY TRANSACTIONS

(b) IAS 24 Related Party Disclosures (continued)

(ii) Transactions with Key Management Personnel ('KMP')
Loans to KMP and their close family members are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for comparable transactions with other persons of similar standing not connected with the Bank, and do not involve more than the normal risk of collectability or present other unfavourable features. Loans to Executive Directors and Senior Executive Officers are made on terms available to other employees in the Bank generally, in accordance with established policy, within limits set on a case by case basis.

The aggregate amounts outstanding, in respect of all loans, quasi loans and credit transactions between the Bank and the KMP, as defined above, together with members of their close families and entities influenced by them are shown in the following table:

	2020	2019
Loans outstanding	**€'000**	€'000
At 1 January	**245**	392
Loans issued during the year	**—**	—
Loan repayments during the year/change of KMP/other	**(57)**	(147)
At 31 December	**188**	245

The balances outlined above include loans, quasi loans and credit transactions held by the connected persons of KMP identified as such during the reporting period. In instances where the KMP were identified post 1 January, no balance has been reported as at 1 January.

(c) Companies Act 2014 disclosures

(i) Loans to Directors
The following information is presented in accordance with the Companies Act 2014. For the purposes of the Companies Act disclosures, Director means the Board of Directors and any past Directors who are Directors during the relevant period. There were 8 Directors in office during the year, 1 of whom availed of credit facilities (2019: 2). The Director who availed of credit facilities had a balance outstanding at 31 December 2020 (2019: 2).

Details of transactions with Directors for the year ended 31 December 2020 are as follows:

	Balance at 31 December 2019	Amounts advanced during 2020	Amounts repaid during 2020	**Balance at 31 December 2020**
	€'000	€'000	€'000	**€'000**
Chris Curley				
Loan	215	—	27	**188**
Interest Charged during year				**6**
Maximum debit balance during the year[1]				**215**

[1]The maximum debit balance is calculated by aggregating the maximum debit balance drawn on each facility during the year.

An immaterial ECL allowance is held on the above facilities at 31 December 2020. All facilities are performing to their terms and conditions.

Simon Ball, Ken Burke, Gerry Gaffney, Yvonne Hill, Dave Keenan, James Murphy and Paul Owens had no facilities with the Bank during 2020.

34. RELATED PARTY TRANSACTIONS
(c) Companies Act 2014 disclosures (continued)

(ii) Connected persons
The aggregate of loans to connected persons of Directors, in office during the year, at 31 December 2020, as defined in Section 220 of the Companies Act 2014, are as follows (aggregate of 3 persons; 2019: 5 persons):

	Balance at 31 December 2020	Balance at 31 December 2019
	€'000	€'000
Loan	**362**	396
Interest Charged during year	**5**	6
Maximum debit balance during year[1]	**396**	508

[(1)]The maximum debit balance is calculated by aggregating the maximum debit balance drawn on each facility during the year.

An immaterial ECL allowance is held on the above facilities at 31 December 2020. All facilities are performing to their terms and conditions.

(iii) Aggregate balance of loans and guarantees held by Directors and their connected persons
The aggregate balance of loans and guarantees held by Directors and their connected persons as at 31 December 2020 represents less than 0.04% of the net assets of the Bank (2019: 0.06%).

(d) Summary of relationship with the Irish Government
The Bank considers that the State is a related party under IAS 24 as it is in a position to exercise significant influence over AIB.

At 31 December 2020, the State held 71.12% of the ordinary shares of AIB Group plc (31 December 2019: 71.12% of the ordinary shares of AIB).

35. NON-ADJUSTING EVENTS AFTER THE REPORTING PERIOD
In the period end February 2021, the Bank agreed to sell non-performing loans in long-term default with a gross carrying value of c. €0.2bn for a cash consideration of approximately €0.2bn.

There have been no other significant events that have affected the Bank since the reporting date which require amendment to or disclosure in the financial statements.

36. PARENT COMPANY
The Bank is a wholly owned subsidiary of AIB. The ultimate parent company of the Bank and AIB is AIB Group plc. The financial statements of AIB and of the ultimate parent company are available from AIB Group plc, 10 Molesworth Street, Dublin 2, Ireland. Alternatively, information can be viewed by accessing AIB's website at www.aib.ie/investorrelations.

37. APPROVAL OF FINANCIAL STATEMENTS
The financial statements were approved by the Board of Directors on 3 March 2021.