



PILLAR 3 DISCLOSURES 2009

AIB Group
31 December 2009

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Background and context

Background

This document represents the 'Pillar 3' disclosures for AIB Group as at 31 December 2009, as required by directives 2006/48/EC and 2006/49/EC, known as the Capital Requirements Directive ("CRD") relating to the taking up and pursuit of the business of credit institutions.

The CRD, which was transposed into Irish law at the end of 2006, introduced some significant amendments to the capital adequacy framework. Its goal is to provide a greater link between the risk a bank faces and the capital it requires, and it does this in a number of ways. In terms of minimum capital requirements ('Pillar 1') it brings greater granularity in risk weightings under the standardised approach for credit risk, and introduces an explicit capital requirement for operational risk.

The CRD also introduces two additional 'pillars'. Under Pillar 2 ('supervisory review') banks may estimate their own internal capital requirements through an Internal Capital Adequacy Assessment Process ("ICAAP"), which is subject to supervisory review and evaluation. Pillar 3 ('market discipline') involves the disclosure of a suite of qualitative and quantitative risk management information to the market.

Basis of disclosures

Allied Irish Banks, p.l.c. ("AIB" or the "Parent Company") and its subsidiaries (collectively "AIB Group" or "Group") prepares consolidated financial statements ("consolidated accounts") under International Financial Reporting Standards ("IFRS").

Allied Irish Banks, p.l.c. is a credit institution authorised by the Financial Regulator. Both the Parent Company and the Group are required to file regulatory returns with the Financial Regulator for the purpose of assessing, *inter alia*, their capital adequacy and their balance sheets.

All subsidiaries are consolidated for both financial statement presentation and regulatory reporting and accordingly for AIB Group the regulatory returns and Financial Statements are similar other than presentation.

The disclosures have been prepared for Allied Irish Banks, p.l.c. and its subsidiaries on a Group consolidated basis. These disclosures cover both the Pillar 3 qualitative and quantitative disclosure requirements.

The Pillar 3 disclosures have been prepared to explain the basis on which the Group has prepared and disclosed capital requirements and information about the management of certain risks and for no other purpose. They do not constitute any form of financial statement and should not be relied upon exclusively in making any judgement on the Group. They should be read in conjunction with the other information made public by AIB Group and available on the AIB Group website, including the Annual Financial Report.

Frequency

This report will be made on an annual basis, with the disclosures based on the financial year-end date of 31 December.

Reporting conventions

The first report prepared in accordance with Pillar 3 was for the year ended 31 December 2008. In this report comparative data is included where relevant.

Disclosure policy

The Group Disclosure Committee approved the formal Pillar 3 disclosure policy during 2009.

Media and location

The Pillar 3 report will be published on AIB Group's website (www.aibgroup.com), alongside the 2009 Annual Financial Report. The Pillar 3 report for 31 December 2008 is also available on this website.

Verification

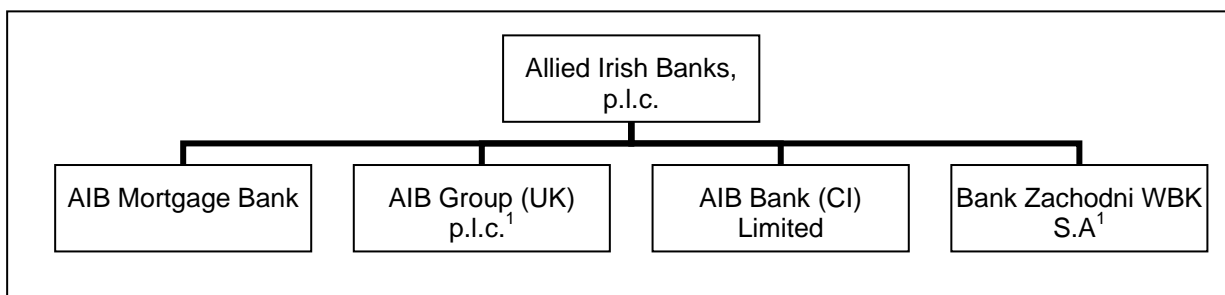
The Pillar 3 disclosures have been subject to internal review procedures broadly consistent with those undertaken for unaudited information published in the 2009 Annual Financial Report and have not been audited by the Group's external auditors. Disclosures are externally audited only to the extent that the information is required to be audited under an accounting or listing requirement.

1. Overview

Basis of consolidation for accounting and prudential purposes

Allied Irish Banks, p.l.c. is the parent company in AIB Group and is a European Economic Area institution regulated by the Financial Regulator. AIB Group prepares consolidated financial statements under International Financial Reporting Standards (“IFRS”) for statutory reporting purposes (“the Consolidated Accounts”). Additionally, AIB Group is required to prepare regulatory returns (“the Regulatory Returns”) for the purpose of assessing its capital adequacy and monitoring its balance sheet. All subsidiaries are consolidated for both Group statutory and regulatory purposes. Details of significant subsidiary (a) capital requirements and (b) risk weighted assets under both (i) Standardised Approach and (ii) Foundation Internal Ratings Based Approach are set out in Appendix 2.

Organisational structure of licensed banks within AIB Group



Transfer of capital between parent company and its subsidiaries

Allied Irish Banks, p.l.c. is the parent company of a number of licensed subsidiary banks and investment firms which are subject to individual capital adequacy requirements. Each of these licensed subsidiaries is subject to minimum capital requirements imposed by their individual regulators and has maintained those ratios above the minimum requirements during the period.

In order to maintain capital and/or liquidity ratios at or above the levels set down by their regulators, the licensed subsidiaries would be unable to remit capital to the parent when to do so would result in such ratios being breached. Apart from this requirement, there is no restriction on the prompt transfer of own funds or the repayment of liabilities between the subsidiary companies and the parent.

Solo consolidation

In the preparation of its financial statements under IFRS, the balance sheet of Allied Irish Banks, p.l.c. includes all activities of the reporting entity including its foreign branches. Transactions between branches of Allied Irish Banks, p.l.c. are excluded in presenting the balance sheet at each reporting date.

The Financial Regulator has adopted the national discretion under Article 70 of the CRD concerning the ability of institutions to include certain subsidiaries in their individual regulatory return. This treatment, termed ‘solo consolidation’, in effect treats such subsidiaries as if they were branches of the parent rather than separate entities in their own right. There are certain criteria that must be met before the Financial Regulator will approve the inclusion of non-authorized subsidiaries in the ‘solo consolidation’. Allied Irish Banks, p.l.c. has received approval to prepare its regulatory return on a solo consolidation basis.

In accordance with the discretion provided for in Article 72 of the CRD and except for the information presented in Annex 2, AIB Group presents its Pillar 3 information on an AIB Group consolidated basis.

¹For the purposes of illustration, intermediate parent companies of AIB Group (UK) p.l.c. and Bank Zachodni WBK S.A. have been omitted from this diagram.

Relationship with the Irish Government

In the second half of 2008 and in 2009, the Irish Government introduced a range of measures, and took a number of steps, to strengthen the Irish banking industry and its participants, including the Group.

The Government's support package commenced with the adoption in late 2008 of a scheme under which the Government guaranteed the deposits and certain other liabilities of participating institutions (including AIB and certain 'covered' subsidiaries) to 29 September 2010. This was followed in May 2009 by the subscription by the Government through the National Pension Reserve Fund Commission ("NPRFC") for € 3.5 billion of non-cumulative redeemable preference shares in AIB. During the fourth quarter of 2009, the Government introduced a modified deposit and liability-specific guarantee scheme to apply to senior unsecured debt obligations of the Group issued prior to 29 September 2010. Finally, the National Asset Management Agency ("NAMA") Act was enacted on 22 November 2009, with participation in NAMA approved by the AIB shareholders on 23 December 2009.

The Irish Government measures referred to above have had a significant impact on the manner in which the Group conducts its business and also resulted in the need for a restructuring plan to be submitted to the Minister for Finance of Ireland, which ultimately requires approval by the European Commission ("EC"). The EC is currently considering the plan and while this evaluation is in progress AIB Group has been precluded from paying dividends on certain of its tier one and upper tier two capital instruments. As a result of the Government Guarantee and the purchase of the preference shares, three non-executive directors have been nominated by the Minister for Finance and appointed to the AIB Board. There are also measures that influence the manner in which the Group extends credit to first time buyers of residential premises, small to medium enterprises ("SMEs") and to other customers. The most significant restriction relates to the manner in which the Group can deal with its NAMA assets.

These Irish Government measures, and the ability of the EC to influence the future composition of the Group's business, are significant factors that may influence our future results and financial condition.

The Irish Government, by virtue of the guarantee scheme and the issue of the € 3.5 billion preference shares to the NPRFC, is a related party to AIB.

Further information on the relationship with the Irish Government is available in Appendix 3: Other relevant disclosures.

Approval for ordinary dividends

A covered institution shall comply with rules made by the Minister for Finance after consultation with the Governor of the Central Bank and Financial Services Authority of Ireland ("Regulatory Authority") governing the declaration and payment of dividends. These rules will take into account the objective of achieving or maintaining the capital ratios, as the Regulatory Authority may direct.

No new dividends shall be declared or paid by a covered institution before such rules are made¹.

No dividend will be paid in respect of the year ended 31 December 2009.

Capital exchange

On 29 March 2010 AIB completed a capital exchange of Euro, Sterling and US Dollar denominated lower tier 2 securities, with a face value of approximately €2,210 million, for the equivalent of €1,765 million of new lower tier 2 capital qualifying issues. The equity accretion for AIB Group arising from the exchange offers is approximately €445 million. Details of the lower tier 2 securities can be found in Appendix 1: Own funds. Further information on this transaction is available on the Group's website (www.aibgroup.com).

Government of Ireland statement

On 30 March 2010 the Minister of Finance of the Government of Ireland issued a statement in relation to (1) the transfer of the first tranche of loans by Irish banks to the National Asset Management Agency ("NAMA"), and (2) decisions made by the Financial Regulator with regard to future capital requirements for Irish banks to be put in place by the end of 2010. Key points extracted from this statement are set out below:

¹Paragraph 42, Statutory Instrument. No. 411 of 2008

Transfer of Loans to NAMA

The original value of the loans transferred to NAMA in the first tranche for AIB is € 3.29 billion from a total of € 23.2 billion. These loans were transferred by AIB into NAMA on 6 April 2010 and the effective discount for these loans on that date was 42% without taking into account the provisions on these loans.

Future capital requirements

The Regulator has advised that Irish banks will require an 8% core tier 1 capital requirement, of which 7% must be equity. The Financial Regulator has performed a detailed assessment of the capital requirements, current and under a stress scenario, over a three year time horizon and has determined the additional capital requirements of each NAMA participating institutions. The capital to meet these requirements must be in place in each of the institutions by end 2010.

The Financial Regulator has determined that AIB must raise an additional equity capital of at least €7.4 billion by the end of the year to meet the new capital base standards. In view of the extent of capital to be raised, AIB is required by the Financial Regulator to produce a detailed capital plan by the end of April 2010.

The Minister's statement recognises that in producing such a capital plan AIB is in a position to raise capital through the sale of overseas assets. As the first step in meeting its capital needs, AIB will immediately commence the process of sale of assets in the US, Poland and in Great Britain. The sale of these assets will be completed this year subject to regulatory clearance.

AIB capital update

On 30 March 2010, in response to the Government of Ireland statement, AIB Group issued a capital update, recognising the new capital requirements being put in place by the Financial Regulator. Key points extracted from the capital update are set out below:

NAMA

As the NAMA process entails a loan by loan exercise, the discount on the first tranche may prove in due course not to represent an accurate discount of the overall portfolio.

The quantum of loans expected to transfer to NAMA is € 23.2 billion for AIB Group. Due to the expected sale of the UK business, it is AIB's intention to review with NAMA the quantum of UK based NAMA loans that would transfer. The amount that could be subject to review is circa € 1.5 billion. Any change to the quantum of NAMA loans transferred would be subject to the consent of NAMA.

Bad debt provisions

AIB has carried out a detailed assessment of the bad debt provision charge expected, excluding NAMA transfers. Over the three year period 2010 to 2012 a provision requirement had been assessed, by individual portfolio and division. The Financial Regulator has requested the inclusion of further prudential buffers for the Irish banking sector which for AIB is € 1.1 billion.

Capital actions – self help

In addition to the recent capital exchange offering noted above AIB are actioning additional self-help options, in particular, asset and business disposals. The distinct assets that AIB propose to sell principally comprise our UK business, our interest in BZWBK and our interest in M&T. AIB currently expects the aggregate proceeds from those sales, based on today's market conditions, to meet a substantial part of our overall need for capital. The Group will receive full credit from the Financial Regulator for disposals which have been agreed at end 2010 but may be awaiting regulatory approvals prior to completion.

Capital actions – equity raising

AIB will undertake an equity capital raising prior to the end of 2010 to fulfil the remaining capital requirement following disposals and other action to that time. Our current intentions are to have an equity issue targeted at private shareholders that would be underwritten by international investment banks or the Government, with any residual requirement met by a conversion of Government preference shares into ordinary shares. The structure, timing and terms of this equity raising are to be further considered in conjunction with the Government. In doing so, AIB intends to respect pre-emption rights of existing shareholders in any capital raising.

AIB note the statement by the Minister for Finance that the Government remains committed to providing equity capital if required. We recognise and are grateful for the significant support that has been provided by the Irish taxpayer over the last 18 months.

2. Risk management - framework

Introductory remarks

While AIB has an established risk management framework, the financial crisis and in particular how it has manifested in substantial credit losses, has led the Group to review its overall approach to identifying, assessing and managing risks. AIB has already taken a number of steps to enhance its risk management infrastructure, including the restructuring of credit functions, and the deployment of significant levels of experienced resources to credit management areas.

A number of other initiatives to further strengthen the Group's risk management processes are planned, some of which are mentioned in the individual risk sections below. AIB will continue to consider, and where appropriate make further enhancements to, its risk framework in response to the changing external environment.

Framework

Risk taking is inherent in the provision of financial services and the Group assumes a variety of risks in undertaking its business activities. Risk is defined as any event that could: damage the core earnings capacity of the Group; increase earnings or cash-flow volatility; reduce capital; threaten business reputation or viability; and/or breach regulatory or legal obligations. AIB has adopted an Enterprise Risk Management approach to identifying, assessing and managing risks. The key elements of the Enterprise Risk Management framework are:

- 2.1 Risk philosophy;
- 2.2 Risk appetite;
- 2.3 Risk governance and risk management organisation;
- 2.4 Risk identification and assessment process;
- 2.5 Risk strategy; and
- 2.6 Stress and scenario testing.

These elements are discussed below.

2.1 Risk philosophy

The Board and senior management set the 'tone at the top'. This establishes the culture, philosophy and behaviour of the Group towards risk and governance, and provides the basis for the engagement of risk governance processes at enterprise, divisional and functional levels. In 2009, the Board has reiterated a set of risk taking principles that reflect the Group's risk philosophy and culture, and articulate the high-level standards against which risk-taking decisions are made. Three key principles are:

- AIB is in the business of taking risk in a controlled manner to enhance shareholder value;
- All risks and related returns are owned by the relevant business units; and
- The risk governance functions perform independent oversight to ensure that key risks are identified and appropriately managed by the relevant business units.

2.2 Risk appetite

The Group's risk appetite framework seeks to encourage appropriate risk taking to ensure that risks are aligned with business strategy and objectives. The Group determines its risk appetite in a 'top-down' and 'bottom-up' fashion. 'Top-down' risk appetite is captured through a range of Board-approved limits and tolerances across risk types. It is also captured through the planning process, whereby the Group considers how much and what type of risk it needs in order to deliver the Group's business objectives and strategy. 'Bottom-up' risk appetite is determined by reference to the risk profile that emerges from the various risk assessment processes used by the Group for individual risk types.

AIB intends to enhance its approach to establishing risk appetite and tolerance, and to strengthen the inter-linkage between risk appetite and business planning across the Group.

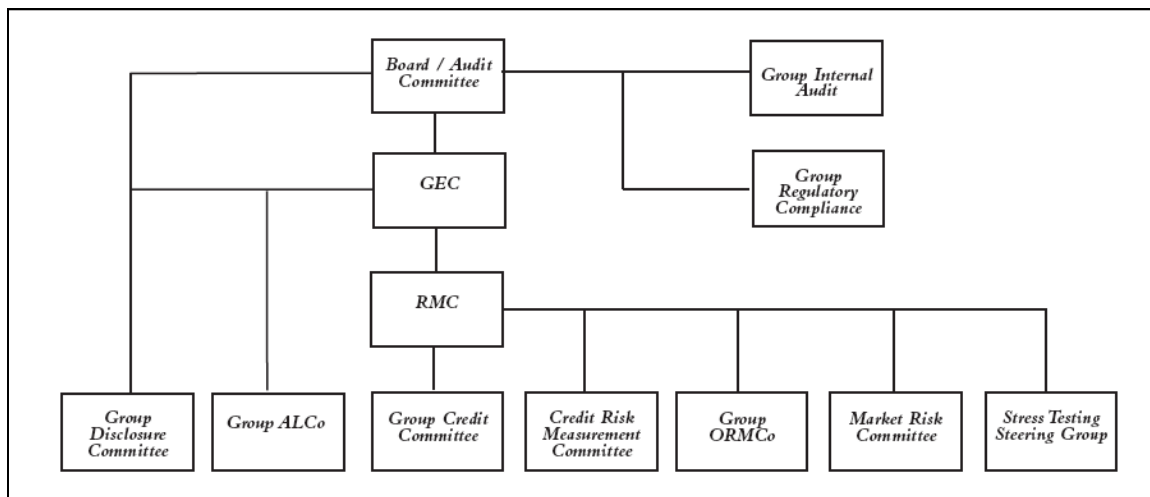
2.3 Risk governance and risk management organisation

The Board and senior management have ultimate responsibility for the governance of all risk taking activity in the Group. AIB uses a ‘three lines of defence’ framework in the delineation of accountabilities for risk governance.

Under the three lines of defence model, primary responsibility for risk management lies with line management. Line management is supported by three Group and Divisional functions with a risk governance role. These are the enterprise-wide Risk, Regulatory Compliance and Finance functions. Together these act as the second line of defence. The third and final line of defence is the Group Internal Audit (“GIA”) function which provides independent assurance to the Audit Committee of the Board on all risk taking activity.

While the Board has ultimate responsibility for all risk-taking activity within AIB, it has delegated some risk governance responsibilities to a number of committees or key officers. The diagram below summarises the Enterprise Committee structure of the Group.

The role of the Board and the Audit Committee is set out in the section on Corporate Governance in the 2009 Annual Financial Report. The Group Executive Committee (“GEC”) is the senior executive committee of the Group. The GEC manages the strategic business risks of AIB and sets the business strategy of the enterprise within which the risk management function operates. The Risk Management Committee (“RMC”) is the highest executive forum for risk governance within the Group. It is responsible for identifying, analysing and monitoring risk exposures, adopting best practice policies and standards, and reviewing risk management activities at an enterprise level.



The RMC acts as the parent body of a number of other risk and control committees, namely the Group Credit Committee, the Credit Risk Measurement Committee, the Group Operational Risk Management Committee (‘Group ORMCo’), the Market Risk Committee and the Stress Testing Steering Group.

The Group Asset and Liability Management Committee (‘Group ALCo’) is responsible for all activities in AIB relating to capital planning and management, funding and liquidity management, structural asset and liability management and the Internal Capital Adequacy Assessment Process (“ICAAP”) – see section 4 Capital and Capital Management.

The Group Disclosure Committee is responsible for ensuring the compliance of the Group’s external disclosures with legal and regulatory requirements, including relevant provisions of the Sarbanes Oxley Act of 2002 (‘Sarbanes-Oxley Act’).

The role of Risk Management and the Group Chief Risk Officer

The Group Chief Risk Officer (“Group CRO”) has independent oversight of the Group’s enterprise-wide risk management activities. The Group CRO is a member of the GEC and reports to the Group Managing Director, with a dotted line to the chairman of the Audit Committee. The Group CRO’s responsibilities include:

- Developing and maintaining the Enterprise Risk Management framework;
- Providing independent reporting to the Board on risk issues, including the risk appetite and risk profile of the Group; and

- Providing independent assurance to the Group Managing Director and Board that material risks are identified and managed by line management and that the Group is in compliance with enterprise risk policies, processes and limits.

Since June 2009, the role of the Group CRO has been performed on a temporary basis by the Group Chief Executive/Managing Director. In addition to the enterprise-wide Risk function, each of the four operating divisions and Operations & Technology has dedicated risk management functions, with divisional CROs reporting directly to the Group CRO.

The role of Finance and the Chief Financial Officer

Finance and the Chief Financial Officer have responsibility for all of the financial processes of the Group. These include financial and capital planning, management accounting, financial disclosures and balance sheet management. Risks embedded in these processes remain the responsibility of the Chief Financial Officer, as does responsibility for compliance with tax legislation as well as external financial and regulatory reporting requirements.

Regulatory Compliance

Regulatory Compliance under the direction of the Group General Manager, Regulatory and Operational Risk, is an enterprise-wide function which operates independently of the business. The function is responsible for identifying compliance obligations arising from 'conduct of business' (customer-facing) regulations in each of the Group's operating markets. There are Regulatory Compliance teams in each division that work closely with management in assessing compliance risks and provide advice and guidance on addressing these risks. Risk-based monitoring of compliance by the business with regulatory obligations is undertaken. The Group General Manager, Regulatory and Operational Risk has a reporting line to the Group CRO and reports independently to the Group Audit Committee on the regulatory compliance and operational risk framework across the Group, and on management's compliance with financial regulation governing conduct of business, money laundering, terrorist financing and operational risk issues.

The Regulatory Compliance function also promotes the embedding of an ethical framework within AIB's businesses to ensure that the Group operates with honesty, fairness and integrity.

Group Internal Audit

Group Internal Audit ("GIA") is an independent evaluation and appraisal function reporting to the Board through the Audit Committee.

GIA acts as the third line of defence in the Group's risk governance organisation and provides assurance to the Audit Committee on the adequacy, effectiveness and sustainability of the governance, risk management and control processes throughout the Group, including the activities carried out by other control functions. The results of GIA audits are reported quarterly to the Audit Committee, which monitors both resolution of audit issues and progress in the delivery of the audit plan.

2.4 Risk identification and assessment process

Risk is identified and assessed in the Group through a combination of top-down and bottom-up risk assessment processes. Top-down processes focus on broad risk types and common risk drivers rather than specific individual risk events, and adopt a forward-looking view of perceived threats over the planning horizon. The key top-down risk assessment process is the Enterprise Risk Assessment, which is undertaken on a six monthly basis. This looks at the material risks facing the Group, as identified by divisional and functional risk review processes, overlaid with an analysis at Group level of emerging threats, industry trends and external incidents.

The Enterprise Risk Assessment is the most significant input into the Material Risk Assessment undertaken for the purpose of the ICAAP under Pillar 2 of the CRD.

Bottom-up risk assessment processes are more granular, focusing on risk events that have been identified through specific qualitative or quantitative measurement tools. A key qualitative tool is self-assessment, which is used in the assessment of operational and regulatory compliance risk. Quantitative tools include the use of internal models to estimate the Probability of Default ("PD"), Loss Given Default ("LGD") and Exposure at Default ("EAD") of credit exposures, and Value at Risk ("VaR") in the context of the Group's trading portfolios.

Top-down and bottom-up views of risk come together through a process of upward reporting of, and management response to, identified and emerging risks. This ensures that the Group's view of risk remains sensitive to emerging trends and common themes.

2.5 Risk strategy

The Group's risk strategy is informed by its risk appetite and the risk profile which emerges from the risk assessment process. To the extent that mismatches are identified between risk appetite and the actual risks being taken, action to address such gaps is undertaken. In the current environment, risk strategy is focused on reducing the risk profile of the Group (particularly in respect of credit and funding risk) to support and enhance the sustainability of the Group.

2.6 Stress and scenario testing

The Group uses stress testing and scenario analysis to supplement its risk assessment processes and to meet its regulatory requirements. The objective of stress testing and scenario analysis is to assess the Group's exposure to extreme, but plausible, events. The Stress Testing Steering Group is a senior committee tasked by the RMC with the (i) approval of stress scenarios, (ii) oversight of the conduct of the analysis and (iii) review of, and decision making on foot of, the results. Regulatory requirements for banking supervision include specific stress tests under Pillars 1 and 2 of the CRD. Under Pillar 1, the Group applies a severe stress to its existing portfolios. Under Pillar 2, the Group stresses its Financial and Capital Plan. In addition, the Central Bank and Financial Services Authority of Ireland requests stress tests from time to time as part of its Financial Stability Assessment and Reporting. The Group continues to seek to enhance its capabilities in assessing the Group's potential vulnerability to extreme scenarios and exogenous shocks, and to meet increased regulatory expectations in respect of stress and scenario testing.

3. Risk management - individual risk categories

This section provides details of the Group's exposure to, and risk management of, the following individual risk types which have been identified through the Group's risk assessment process:

- 3.1 Credit risk;
- 3.2 Market risk;
- 3.3 Non-trading interest rate risk;
- 3.4 Structural foreign exchange risk;
- 3.5 Liquidity risk;
- 3.6 Operational risk; and
- 3.7 Regulatory Compliance risk.

Further information is available in the 2009 Annual Financial Report, which is available on the Group's website (www.aibgroup.com).

3.1 Credit risk

Credit risk is defined as the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into and that the Group is unable to recover the full amount that it is owed through the realisation of any security interests. The most significant credit risks arise from lending activities to customers and banks, trading portfolio, available for sale, held for sale and held to maturity financial investments, derivatives and 'off-balance sheet' guarantees and commitments. The credit risks arising from balances at central banks, treasury bills and items in course of collection are deemed to be negligible based on their maturity and counterparty status.

While the way in which the Group manages and controls credit risk is outlined in the following sections, the Group has responded to the continuing severe deterioration in elements of our credit portfolio by implementing a number of changes in the management of credit risk which include:

- Integrating the credit functions across the Group under the functional responsibility of the Group Chief Credit Officer;
- A restructure of the credit function to:
 - provide dedicated focus on workout and debt restructuring;
 - meet the needs of existing and new borrowers; and
 - have an enhanced framework for credit approval and monitoring.
- A significant number of experienced credit personnel have been redeployed to the management of our criticised loan portfolio, i.e. Watch, Vulnerable and Impaired loans. The objective of these criticised loan teams is the proactive management, in terms of earlier identification and more intensive management of problem loans, with a view to minimising the loss impact of borrower failure;
- Credit authorities have also been revisited and amended where appropriate;
- Certain credit policies have been revisited and amended where appropriate; and
- A dedicated project team has been established to identify NAMA eligible assets and to ensure that the Group is prepared for their transfer to NAMA.

The Group continues to monitor market dynamics to update property collateral valuations, assess borrower liquidity and early warning signs for all sectors.

Further restructure and reorganisation of the credit and credit risk functions is planned which will enhance its credit management framework to reflect changes in the strategies of the Group and to ensure that they are appropriate for managing the risk inherent in its market environment. This is particularly relevant in today's environment and against the background of significant losses sustained in our credit portfolio. An integral part of these planned changes will be to align the Group's credit risk appetite with the Group's strategic plan to ensure appropriate risk taking within key concentration limits and a review of key credit policies including the Group Large Exposures Policy ("GLEP").

Credit risk on derivatives

The credit risk on derivative contracts is the risk that the Group's counterparty in the contract defaults prior to maturity at a time when AIB has a claim on the counterparty under the contract. AIB would then have to replace the contract at the current market rate, which may result in a loss. Derivatives are used by AIB to meet customer needs, to reduce interest rate risk, currency risk and in some cases, credit risk, and also for proprietary trading purposes. Risks associated with derivatives are managed from a credit, market and operational perspective. The credit exposure is treated in the

same way as other types of credit exposure and is included in customer limits. The total credit exposure consists partly of current replacement cost and partly of potential future exposure. The potential future exposure is an estimation, which reflects possible changes in market values during the remaining life of the individual contract. The Group uses a simulation tool to estimate possible changes in future market values and computes the credit exposure to a high level of statistical significance.

Country risk

Credit risk is also influenced by country risk, where country risk is defined as the risk that circumstances arise in which customers and other counterparties within a given country may be unable to fulfil or precluded from fulfilling their obligations to the Group due to economic or political circumstances.

Country risk is managed by setting appropriate maximum risk limits to reflect each country's overall credit worthiness. These limits are informed by independent credit information from international sources and supported by periodic visits to relevant countries. Risks and limits are monitored on an ongoing basis.

Settlement risk

Settlement risk arises in any situation where a payment in cash, securities or equities is made in the expectation of a corresponding receipt in cash, securities or equities. The settlement risk on many transactions, particularly those involving securities and equities, is substantially mitigated when effected via assured payment systems, or on a delivery-versus-payment basis. Each counterparty is assessed in the credit process and clearing agents, correspondent banks and custodians are selected with a view to minimising settlement risk. The most significant portion of the Group's settlement risk exposure arises from foreign exchange transactions. Daily settlement limits are established for each counterparty to cover the aggregate of all settlement risk arising from foreign exchange transactions on a single day.

Credit concentration risk

Credit concentration risk arises where any single exposure or group of exposures, based on common risk characteristics, has the potential to produce losses large enough relative to the Group's capital, total assets, earnings or overall risk level to threaten its health or ability to maintain its core operations.

Risk identification and assessment

Credit risk is identified, assessed and measured through the use of credit rating and scoring tools for each borrower or transaction. The methodology used produces a quantitative estimate of PD for the borrower. This assessment is carried out at the level of the individual borrower or transaction and at sub-portfolio, portfolio, business unit and/or divisional level where relevant.

In the retail consumer and small and medium sized entity ("SME") book, which is characterised by a large number of customers with small individual exposures, risk assessment is largely informed through statistically-based scoring techniques. Both application scoring for new customers and behavioural scoring for existing customers are used to assess and measure risk as well as to facilitate the management of these portfolios. In the commercial, corporate and interbank books, the rating systems utilise a combination of objective information, essentially financial data, and qualitative assessments of non-financial risk factors such as management quality and competitive position. The combination of expert lender judgement and statistical methodologies varies according to the size and nature of the portfolio together with the availability of relevant default experience.

The ratings influence the management of individual loans. Special attention is paid to lower quality rated loans and, when appropriate, loans are transferred to special units to help avoid default or, when in default, to minimise loss.

Credit concentration risk is identified and assessed at single name counterparty level and at portfolio level. The Board-approved GLEP sets the maximum limit by grade for exposures to individual counterparties or group of connected counterparties. Portfolio concentrations are identified and monitored by exposure and grade using internal sector codes.

Such measures facilitate the measurement of concentrations by balance sheet size and risk profile relative to other portfolios within the Group and in turn facilitate appropriate management action discussion and decision making.

Role of stress and scenario analysis in the assessment of credit risk

The Group conducts periodic stress tests on specific portfolios to assess the impact of credit concentrations and to assist the identification of any additional concentration in its loan books. These tests are carried out as required by senior management. Additional stress tests are carried out to assist capital planning under the CRD. Stress tests undertaken on the Group's credit portfolios form a significant part of the Group's Pillar 1 and Pillar 2 stress tests as described in section 2.6.

Risk management and mitigation

A framework of delegated authorities supports the Group's management of credit risk. Credit grading, scoring and monitoring systems facilitate the early identification and management of any deterioration in loan quality. The credit management system is underpinned by an independent system of credit review.

Delegated authority is a key credit risk management tool. The Board determines the credit authority for the Group Credit Committee ("GCC") and divisional Credit Committees, together with the authorities of the Group Managing Director and the Group Chief Credit Officer. The GCC considers and approves credit exposures which are in excess of divisional credit authorities. Delegated authorities below these levels have been clearly defined and are explicitly linked to levels of seniority within the Group.

Key credit policies are approved by the Board. Divisional management approves divisional credit policy within the parameters of relevant Group level policies. The divisional risk management function is an integral part of the approval process of divisional policies. Material divisional policies are referred to the Risk Management Committee ("RMC") and/or to the Board, where relevant, for approval.

The GLEP sets out a framework for the management of single-name credit concentrations. Any exceptions to limits are highlighted and reported to the RMC and, as appropriate, also to the Board.

Levels of concentrations by geography, sector and product are effectively set through the divisional and Group planning process.

Credit risk mitigation

In relation to individual exposures, while the perceived strength of the borrower's repayment capacity is the primary factor in granting the loan, AIB uses various approaches to help mitigate risks in individual credits including: transaction structure, security, and guarantees. These items of collateral or guarantees are required as a secondary source of repayment in the event of the borrower's default. Guidelines covering the acceptability of different forms of security and how it should be valued are outlined in the various divisional policy papers. The main types of collateral for loans and receivables to customers are as follows:

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

Corporate/Commercial Lending: For property related lending, it is normal practice to take a charge over the property being financed. This includes investment and development properties. For non-property related lending, collateral typically includes a charge over business assets such as stock and debtors but may also include property. In some circumstances, personal guarantees supported by a lien over personal assets are also taken as security. The Group does not disclose the fair value of collateral held against past due or impaired financial assets as it would be operationally impracticable to do so. Very occasionally, credit derivatives are purchased to hedge credit risk. Current levels are minimal and their use is subject to the normal credit approval process.

The Group enters into master netting agreements with counterparties, to ensure that if an event of default occurs, all amounts outstanding with those counterparties will be settled on a net basis.

In the case of large exposures, it is sometimes necessary to reduce initial deal size through appropriate sell-down and syndication strategies. There are established guidelines in place relating to the execution of such strategies.

The Group also has in place an interbank exposure policy which establishes the maximum exposure for each Bank depending on grade. Each Bank is then assessed for the appropriate exposure limit within the policy. Risk generating business units of each division 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.

Provisioning for impairment

The identification of loans for assessment as impaired is driven by the Group's rating systems. The Group provides for impairment in a prompt and consistent way across the credit portfolios. The rating models provide a systematic discipline in the identification of loans as impaired and in triggering a need for provisioning on a timely basis.

Loans are identified for assessment as impaired if they are past due typically for ninety days or more or exhibit, through lender assessment, an inability to meet their obligations to the Group.

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

Specific Provisions

Specific provisions arise when the recovery of a specific loan or group of loans is significantly in doubt. The amount of the specific provision will reflect the financial position of the borrower and the net realisable value of any security held for the loan or group of loans. In practice, the specific provision is the difference between the present value of expected future cash flows for the impaired loan(s) and the carrying value. When raising specific provisions, AIB divides its impaired portfolio into two categories, namely individually significant and individually insignificant.

Individually significant impairment

Each division sets a threshold above which cases are assessed on an individual basis. For those credits identified as being impaired and which require assessment on an individual basis, the impairment provision is calculated by discounting the expected future cash flows at the exposure's effective interest rate and comparing the result (the estimated recoverable amount) to the carrying amount of the loan to determine the level of provision required. Specific provisions for larger loans (individually significant) are raised by reference to the individual characteristics of each credit including an assessment of the value of collateral held. Some key principles have been applied particularly in respect of property collateral held by the Group as property impaired loans amounted to € 13.4 billion (31 December 2008: € 1.7 billion) of the Group's total impaired loans of € 17.5 billion (31 December 2008: € 3.0 billion).

For impaired property and construction exposures, cash flows will generally emanate from the development and/or disposal of the assets which comprise the collateral held by the Group. AIB typically holds various types of collateral as security for these loans, e.g. land, developments available for sale/rent and investment properties or a combination of these assets via cross collateralisation.

The Group uses a number of methods to assist in reaching appropriate valuations for its collateral given the absence of a liquid market for property related assets. These include: consultations with valuers; use of professional valuations; use of residual value methodologies; and the application of local market knowledge in respect of the property and its location.

Consultations with valuers would represent circumstances where local external valuers are asked to give verbal "desk top" updates on their view of the assets' value. Consultation also takes place on general market conditions to help inform the Group's view on the particular property valuation. The valuers are external to the Group and are familiar with the location and asset for which the valuation is being requested.

Use of professional valuations would represent circumstances where external firms are requested to provide formal written valuations in respect of the property. Up to date external professional valuations are sought in circumstances where it is believed that sufficient transactional evidence is available to support an expert objective view. Given the significant dislocation in the property markets during 2009, professional valuations were often unavailable or unreliable because of the lack of transactional evidence. Historic valuations are also used as benchmarks to compare against current market conditions.

The residual value methodology assesses the value in the land or property asset after meeting the incremental costs to complete the development. This approach looks at the cost of developing the asset to determine the residual value for the Group, including covering the costs to complete and additional funding costs, to maximise the expected residual cash flows from completing the development. The key factors considered are: (i) the development potential given the location of the asset; (ii) its current or likely near term planning status; (iii) levels of demand; (iv) all relevant costs associated with the completion of the project and (v) expected market prices of completed units. Some elements of this approach are derived from one or a combination of the other valuation methodologies outlined. If, following internal considerations which include consultations with valuers, the optimal value for the Group will be obtained through the development/completion of the project; a residual value methodology is used.

Application of local market knowledge would represent circumstances where the local bank management familiar with the property concerned, with local market conditions, and with knowledge of recent completed transactions would provide indications of the likely realisable value and a potential timeline for realisation.

After applying one of the above methodologies or a combination of these, valuation outcomes have resulted in a wide range of discounts (typically 30% - 90%) influenced by the nature, status and year of purchase of the asset. All 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. land, developed land or investment property and also its location. The valuation arrived at is therefore a function of the nature of the asset, e.g. unserviced land in a rural area will most likely suffer a greater reduction in value if purchased at the height of a property boom than a fully let investment property with strong lessees. The discounts to original value, having applied our valuation methodologies to reflect current market conditions, are typically as follows:

- Land urban 30% to 60%
- Land rural Greater than 60%
- Developed land/partially developed, i.e. with completed stock 30% to 50%
- Investment property 30% to 60%

The above approach and typical discount rates relate to collateral valuations and not loan valuations, as loans were originated at loan to value ("LTVs") of an average 75%/80%.

At 31 December 2009 € 10.5 billion (2008: € 1.5 billion) of the Group's property and construction impaired loans related to land and development which includes undeveloped land, together with land with developments in course of construction/development and depending on the facts and circumstances of each case, AIB uses different methodologies, as described above, in assessing the value of such collateral.

A further € 2.7 billion (2008: € 0.2 billion) related to loans with investment property assets as collateral. Investment property assets comprise completed developments which are available for letting or disposal in their current condition. In some cases the asset will be generating rental income. Valuations are completed using recent professional valuation and/or by consulting with external valuers', who provide opinions on current values based on yields for similar investment asset class and location. These valuations and opinions are independently reviewed and challenged internally as to their appropriateness.

When assessing the level of provision required for property loans, apart from the value to be realised from the collateral, the other key driver is the time it takes to receive the funds from the realisation of security. While it depends on the type of security and the stage of its development, the period of time to realisation is typically two to seven years but sometimes this time period is exceeded. These estimates are frequently reassessed on a case by case basis. In accordance with IAS 39, AIB discounts these cash flows at the assets' effective interest rate to calculate their net present value and compares this with the carrying value of the asset, the difference being the level of provision required.

Each division has a dedicated workout unit whose function it is to monitor and proactively manage impaired loans. Ultimately the specialised loan 'work-out' manager will decide on the method(s) to be used, based on his/her expert judgement. The 'work-out' manager then recommends the required provision to the appropriate approval authority. The Group operates a tiered approval framework for provisions which are approved, depending on amount, by various delegated authorities up to Divisional Credit Committee/Special Credit Committee level. These committees are chaired by the Divisional Chief Credit Officer/Managing Director, where the valuation/provision is reviewed and challenged for appropriateness and adequacy. Provisions in excess of divisional authorities are approved by the GCC.

These approaches and valuation outcomes are documented and the resultant provisions are reviewed and challenged as part of the approval process by the relevant delegated credit authority on a quarterly basis.

Individually insignificant impairment

The calculation of an impairment charge for credits below the 'significant' threshold is undertaken on a collective basis. Loans are grouped together in homogeneous pools sharing common characteristics. Recovery rates are established for each pool by assessing the Group's loss experience for these pools over the past four to five years. Loss experience is determined by examining the amount and timing of cash flows received (typically over four years) from the date the loan was identified as impaired, then discounted at the loan's effective interest rate. These recovery rates are updated on a

half-yearly basis. Provisions are then raised on new impaired loans reflecting the Group's updated recovery experience.

While a uniform approach is adopted throughout the Group, depending upon the range/depth of customer and portfolio information available, the methodologies used in establishing the level of impairment may vary within the divisions. The nature of the asset pools may also differ within divisions.

When a loan has been subjected to a specific provision and the prospects for recovery do not improve, a point will come when it may be concluded that there is no realistic prospect of recovery. When that point is reached, the amount of the loan which is considered to be beyond prospect of recovery is charged off. The management process for the identification of loans requiring provision is underpinned by independent tiers of review. Credit quality and impairment provisioning are independently monitored by credit and risk management on a regular basis. A group wide system for rating advances according to agreed credit criteria exists with an important objective being the timely identification of vulnerable loans so that remedial action can be taken at the earliest opportunity. The rating of an exposure is fundamental to the determination of provisioning in AIB Group; it triggers the process which results in the creation of a specific provision on individual loans where there is doubt on recoverability.

Collective impairment for performing book (Incurred but not reported loss)

IBNR provisions are maintained to cover loans which are impaired at balance sheet date and, while not specifically identified, are known from experience to be present in any portfolio of loans. IBNR provisions can only be recognised for incurred losses and are not permitted for losses that are expected to happen as a result of likely future events. IBNR provisions are determined by reference to loss experience in the portfolios and to the credit environment at balance sheet date.

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

The approach used for the collective evaluation of impairment is to split the performing financial assets into homogeneous pools on the basis of similar risk characteristics. The asset pools are multiplied by the 'average annual loss rate' for that pool, suitably adjusted where appropriate by management for any factors currently affecting the portfolio that may not have been a feature in the past or vice versa. The resultant amount is then adjusted to reflect the emergence period, i.e. the time it takes following a loss event for an individual loan to be recognised as impaired requiring a specific provision.

The emergence period is key in determining the level of collective provisions. Emergence periods for each divisional portfolio are determined by taking into account current credit management practices, historical evidence of assets moving from 'good' to 'bad' as a result of a 'loss event' and will include actual case studies. The range of emergence periods applied by AIB is three to twelve months with the majority of the portfolio having a three to six month emergence period applied.

Risk monitoring and reporting

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

Credit risk at a portfolio level is monitored regularly and reported on a monthly basis to senior management and the Board. Monthly reporting typically includes but is not limited to information on advances, concentrations, provisions and grade profiles and trends. A more detailed credit review is prepared for the Board on a quarterly basis.

Single name counterparty concentrations are monitored at transaction level. Large exposures are reported monthly to senior management and quarterly to the Board. Portfolio concentrations are monitored and reported monthly at divisional and Group level. More detailed reports are prepared quarterly at Group level, which outline trends by exposure and grade for key concentrations.

In addition to the regular suite of reports, the Board also receives periodic ad hoc reports on specific aspects of credit risk.

Credit performance measurement framework

The Group continues to refine its methodology for measuring the risk adjusted profitability of its credit business. Economic Value Added ("EVA") is one of the primary measures of performance used largely for corporate business. EVA represents the value added having deducted all costs, including expected loss and a charge for the economic capital required to support the facility. The most

important inputs into the determination of the expected loss and the economic capital are the PD, the LGD and the EAD. The grades produced by the rating models are translated into a PD, which is a key parameter when measuring risk. LGD is measured taking into account, inter alia, the security held by the Group. EAD for many products is equal to the outstanding exposure but for some products, such as credit lines and derivative contracts, the EAD may be higher than the outstanding exposure.

3.2 Market risk

Market risk refers to the uncertainty of returns attributable to fluctuations in market factors, such as adverse movements in the level or volatility of market prices of debt instruments, equities and currencies. Where the uncertainty is expressed as a potential loss in value, it represents a risk to the income and capital position of the firm. The Group assumes market risk as a consequence of the risk management services it provides to its client base and through risk positioning in selected wholesale markets. In addition, the Group assumes market risk as a result of its pro-active balance sheet and capital management activity (see Capital and Capital management).

Fundamental to the Group's market risk policy is that management of the Group's principal market risks (i.e. interest rate and foreign exchange) is centralised within the Global Treasury business unit where the necessary expertise, processes and systems are maintained. This ensures that all parts of the Group neutralise their interest rate and foreign exchange rate risk, leaving their planned margin/fees unaffected by changes in financial market rates.

Global Treasury is also authorised to trade on its own account in selected wholesale markets. The strategies employed are desk and market specific and approved on an annual basis by the Market Risk Committee. Much of Global Treasury's market risk appetite is expressed through strategic interest rate positioning in bond and derivatives markets. Trading strategies are determined mainly by the objective of the trading desk, the importance of customer flows and the view of the market. Examples include directional trading, spread trading, relative value trading, range trading and straight yield curve views.

The Group's brokerage businesses are similarly mandated to take moderate equity risk, specifically Goodbody's principal trading team (located in the Capital Markets division) and Dom Maklerski's equity market-making team (the BZWBK brokerage house, located in the CEE division).

The Group has not sought regulatory approval for use of its market risk models for regulatory capital purposes.

Further information and analysis is available in the 2009 Annual Financial Report on the Group's website (www.aibgroup.com).

Risk identification and assessment

Separate risk functions exist within each trading business and are tasked with capturing all material sources of market risk within the trading portfolios. In addition to the standard risk factors, credit spreads, liquidity issues, non-linearity and risk concentrations are also considered. A 'New Products' protocol complements the risk identification and assessment process by acting as a gateway to the trading portfolio. An integral element of the process is the ongoing dialogue between dealers and risk analysts, in both formal and informal settings.

In quantifying the portfolio's market risk profile, the Group's risk measurement systems are configured to address all material risk factors, including price dynamics, volatilities and correlation behaviour. The Group's core risk measurement methodology is based on a variance co-variance application of the industry standard value at risk ("VaR") technique that incorporates the portfolio diversification effect within each standard risk factor (interest rate, foreign exchange, equity, as applicable). The resulting VaR figures, calculated at the close of business each day, are an estimate of the probable maximum loss in fair value over a one month holding period that would arise from a 'worst case' movement in market rates. This 'worst case' is derived from an observation of historical prices over a period of three years, assessed at 99% statistical confidence level. Instruments with significant embedded or explicit option characteristics receive special attention, including Monte Carlo simulation and a full analysis of option sensitivities.

Although an important measure of risk, VaR has limitations as a result of its use of historical data, assumed distribution, holding periods and frequency of calculation. Furthermore, the use of confidence intervals does not convey any information about potential loss when the confidence level is exceeded. The Group recognises these limitations and supplements its use with a variety of other techniques, including sensitivity analysis, interest rate gaps by time period and daily open foreign exchange and equity positions. Stress-testing and scenario analysis are employed on an ongoing basis to gauge the Group's vulnerability to loss under stressful market conditions. For example, for

interest rate risk portfolios, principal components analysis (“PCA”) is used to analyse interest rate term structure factor sensitivity measures, i.e. it identifies the three most predictive elements driving interest rate changes, namely parallel shift, twist and bow. Potential worst case outcomes are derived by combining PCA analysis with Monte Carlo simulation, using over 10,000 possible yield curve shifts. In addition, stressed outcomes derived from revaluing the current portfolio using specific historical scenarios which incorporate historical observations of market moves during previous periods of market stress. For foreign exchange and equity portfolios, historical simulation techniques are used to determine potential worst case outcomes. Stress-testing results are reported to senior management, providing them with an assessment of the financial impact such events would have on the portfolio.

Risk management and mitigation

In managing and overseeing market risk, the Group makes a distinction between its trading and non-trading activities. Trading occurs when front line management exercises its discretion, subject to allocated market risk limits, to increase, hold, hedge or exit the market risk inherent in a given position. All such trading positions, including equity market-making, are subject to the rigour of the market risk management framework and are overseen by a Market Risk Committee, irrespective of accounting or regulatory treatment. The Group refers to all other positions that are structural in nature as ‘non-trading’ i.e. market risks inherent in the structure of the Group’s balance sheet that are non-proprietary in nature, for example non-interest earning current account balances. The Group ALCo is responsible for the oversight of these activities and the appropriate strategies for measuring and hedging these risks. From a regulatory perspective, these positions are always recorded in the ‘banking book’.

The majority of the Group’s managed positions also meet the criteria for inclusion in the regulatory-defined ‘banking book’ and any changes in fair value are accounted for in reserves. The balance of the risk positions including all derivative activity, other than those in hedge accounting relationships, and all equity market-making transactions meet the criteria for inclusion in the regulatory defined ‘Trading Book’ and are accounted for at fair value through profit or loss.

Market risk management in the Group has a number of inter-related components. As a management process, it is actively administered on the basis of clearly delegated authorities that reflect the appropriate segregation of duty, fit for purpose trading environments with enabling technology and competent personnel with relevant skill and experience. It should be noted that credit risk issues inherent in the market risk portfolios are subject to the credit risk framework that was described in the previous section. A comprehensive suite of policies and standards clarifies roles and responsibilities, and provides for effective risk assessment, measurement, monitoring and review of trading positions.

Market risk management aligns with trading business strategy through the articulation of an annual risk strategy and appetite statement. Risk appetite is defined as the level and nature of risk the trading businesses are willing to accept in pursuit of value. Market risk appetite addresses the question of how much and what type of market risk is acceptable to the Group and is consistent with its overall business strategy.

Market risk portfolios are managed both in terms of their risk and financial impacts. Risk perspective: the Group uses VaR limits to control the impact of market risk activities on tier 1 capital – the Group employs a matrix of such limits across the trading businesses; Financial perspective: the Group uses an earnings constraint (limit) to control the income statement impact of capital erosion by defining the maximum tolerance for recognising losses in a given reporting period. Stop loss mechanisms at the trader level form part of this process. Management of the financial dimension of market risk activity is supplemented with limits on the portfolio’s permissible negative embedded value.

Risk monitoring and reporting

Quantitative and qualitative information is used at all levels of the organisation, up to and including the Board, to identify, assess and respond to market risk. The actual format and frequency of risk disclosure depends on the audience and purpose and ranges from transaction-level control and activity reporting to enterprise level risk profiles. For example, front office and risk functions receive the full range of daily control and activity, valuation, sensitivity and risk measurement reports, while the Board receives a monthly market risk commentary and summary risk profile.

3.3 Non-trading interest rate risk

Non-trading interest rate risk, also referred to as interest rate risk in the banking book (“IRRBB”), is defined as the Group’s sensitivity to earnings volatility in its non-trading activity arising from movements in interest rates. It reflects a combination of non-trading treasury activity and interest rate risk arising in the Group’s retail, commercial and corporate operations. AIB’s treasury activity includes its money market business and management of internal funds flows with the Group’s businesses. These treasury transactions are also captured under the market risk VaR assessment measure. Non-trading interest rate risk in retail, commercial and corporate banking activities can arise from a variety of sources, including where those assets and liabilities and off-balance sheet instruments have different repricing dates.

Risk identification and assessment

Banking book interest rate risk is calculated in each business unit on the basis of establishing the repricing behaviour of each asset, liability and off-balance sheet product. For some products the actual interest repricing characteristics differ from the contractual repricing arrangements. In these cases, the repricing maturity is determined by the market interest rates that most closely fit the behaviour of the product interest rate. For non-interest bearing current accounts, the repricing maturity is determined by the stability of the portfolio. The assumptions behind these repricing maturities and the stability levels of portfolios are reviewed annually by the relevant divisional asset and liability committees. The risks from these exposures are managed through a series of VaR, basis point sensitivity and earnings at risk measures.

Risk management and mitigation

As a core risk management principle, the Group requires that all material interest rate risk is transferred to Global Treasury. This transferred banking book risk is managed as part of Global Treasury’s overall interest rate risk position. The Group manages structural interest rate risk volatility by maintaining a portfolio of instruments with interest rates fixed for several years. The size and maturity of this portfolio is determined by characteristics of the interest-free or fixed-rate liabilities or assets and, in the case of equity, an assumed average maturity.

Risk monitoring and reporting

Group ALCo monitors the Group’s banking book interest rate risk and has oversight responsibility for non-treasury banking book risk. Treasury banking book risk is overseen by the Market Risk Committee. Group ALCo meets on a monthly basis and receives standing reports on the Group’s asset and liability risk profile. It monitors positions against these limits on a monthly basis. The Board reviews and approves relevant policies and limits.

3.4 Structural foreign exchange risk

Structural foreign exchange rate risk arises from the Group’s non-trading net asset position in foreign currencies. This arises almost entirely from the Group’s net investments in its sterling, US dollar and Polish zloty-based subsidiaries and associates.

Risk identification and assessment

The Group prepares its consolidated balance sheet in euro. Accordingly, the consolidated balance sheet is affected by movements in the exchange rates between these currencies and the euro. Due to the Group’s diversified international operations, the currency profile of its capital may not necessarily match that of its assets and risk-weighted assets. These positions are not actively hedged, although some mitigation of euro/sterling and euro/zloty positions arises from the Group’s capital structure.

The Group also has a structural exposure to foreign exchange risk arising from its share of earnings from overseas subsidiaries and associates. Group ALCo sets the framework for and reviews the management of these activities. Open positions are reported as differences between expected earnings in the current year and the value of hedges in place.

Risk management and mitigation

The Group’s structural foreign exchange hedging activity is overseen by the Hedging Committee, a sub-committee of the Group ALCo. The objective of the Group’s hedging policy is to manage the Group’s foreign currency earnings within tolerance levels based on the budget for the forthcoming year, making use of other natural hedges within the Group’s balance sheet where these are available.

Risk monitoring and reporting

Group ALCo monitors the Group's structural foreign exchange risks. It meets on a monthly basis and receives standing reports on the Group's asset and liability risk profile including structural foreign exchange risk. The Board reviews and approves relevant policies and limits.

3.5 Liquidity risk

The objective of liquidity management is to ensure that, at all times, the Group holds sufficient funds to meet its contracted and contingent commitments to customers and counterparties at an economic price. Throughout the difficult market conditions of 2009, the Group's liquidity management process has proved itself to be robust in maintaining its liquidity position.

Risk identification and assessment

Liquidity risk is assessed by modelling the net cash outflows of the Group over a series of maturity bands. Behavioural assumptions are applied to those liabilities whose contractual repayment dates are not reflective of their inherent stability. These net cash outflows are compared against the Group's stock of liquid assets to consider, within each maturity band, the adequacy of the Group's liquidity position.

Risk management and mitigation

The objective of the Group's liquidity management policy is to ensure that the Group can at all times meet its obligations as they fall due at an economic price. The Group achieves this in a number of ways. Firstly, through the active management of its liability maturity profile, it ensures a balanced spread of repayment obligations with a key focus on 0-8 day and 9-31 day time periods. Monitoring ratios apply to periods in excess of 31 days. Secondly, the Group maintains a stock of high quality liquid assets to meet its obligations as they fall due. Discounts are applied to these assets based upon their cash-equivalence and price sensitivity. The Group's stock of liquid assets and contingent funding facilities are maintained at a level considered sufficient to meet the withdrawal of deposits or calls on commitments in both normal and abnormal trading conditions. In all cases, net outflows are monitored on a daily basis. Finally, the Group maintains a diversified funding base across all segments of the markets in which it operates, while focusing on minimising concentration in any single source of funding and maintaining a balance between short-term and long-term funding sources.

Customer deposits represent the largest source of funding, with the Group's core retail franchise and accompanying core retail deposit base in Ireland, the UK and Poland providing the Group with a stable and reasonably predictable source of funds. Although a significant element of these retail deposits are contractually repayable on demand or at short notice, the Group's customer base and geographic spread generally mitigates against this risk.

The Group monitors and manages the funding support provided by its deposit base to its loan book through a series of measures including its externally reported customer loan to deposit ratio. More refined measures are utilised internally which recognise the capacity to generate contingent liquidity out of the Group's loan book, the structure of the Group's wholesale term funding and the stability of its customer deposit base. The Group's customer loan-to-deposit ratio increased from 140% at 31 December 2008 to 146% at 31 December 2009 (123% excluding loans and receivables held for sale to NAMA).

Global Treasury, through its Wholesale Treasury operations manages, on a global basis, the liquidity and funding requirements of the Group. Euro, sterling, US dollar and Polish zloty represent the most important currencies to the Group from a funding and liquidity perspective. Global Treasury is active in the wholesale funding markets including the interbank and corporate deposit market. This is supplemented by commercial paper, certificate of deposit, medium term note, covered bond and other issuance programmes which serve to further diversify the Group's sources of funding. Challenging market conditions in 2009 resulted in a contraction of wholesale market appetite on the part of participants for liquidity risk. This manifested itself through a shortening of duration in wholesale funding available, leading to a contraction in the term funding profile of many institutions including AIB. As a consequence, AIB had to increase its use of secured funding to offset reduced wholesale market activity experienced in the first half of 2009. AIB has decreased its use of secured funding in the latter part of the year as markets became less stressed. This was evident in AIB's successful issuance of two senior unsecured un-guaranteed bonds (€ 1.0 billion three-year and € 750 million five-year) in the second half of 2009.

During 2009, AIB increased its qualifying liquid asset and contingent funding capacity, through the structuring of loan portfolios into central bank eligible assets. Such initiatives have helped to increase the Group's capacity to access further liquidity.

AIB has successfully issued a series of medium term notes totalling over €6 billion under the Credit Institutions (Financial Support) Scheme 2008 ('the CIFS Scheme') in 2009. The Irish Government introduced the Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 ('the ELG Scheme') on 9 December 2009. AIB joined the ELG Scheme on 21 January 2010.

The Group's debt rating for all debt/deposits not covered by the CIFS Scheme/ELG Scheme are as follows: Moody's long-term "A1" and short-term "P-1"; Fitch long-term "A-" and "F1" short-term; Standard and Poor's long-term single "A-" and "A-2" short term.

The Group's debt rating for all debt/deposits covered by the CIFS Scheme /ELG Scheme are as follows: Moody's long-term "Aa1" and short-term "P-1", Fitch long-term "AA-" and short-term "F1+"; Standard and Poor's long-term "AA" and short-term "A-1+".

The Group's liquidity management policy ensures that it has sufficient liquidity to meet its current requirements. In addition, it operates a funding strategy designed to anticipate additional funding requirements based upon projected balance sheet movements. The Group undertakes liquidity stress testing and contingency planning to deal with unforeseen events. Stress tests include both firm specific and systemic risks events. These scenario events are reviewed in the context of the Group's liquidity contingency plan, which details corrective action options under various levels of stress events. The purpose of these actions is to ensure continued stability of the Group's liquidity position, within the Group's pre-defined risk tolerance levels.

The Group's approach to liquidity management complies with the Financial Regulator's revised 'Requirements for the Management of Liquidity Risk', introduced in July 2007 and the Group regulatory ratio requirements for liquidity were met throughout 2009.

Risk monitoring and reporting

The liquidity position of AIB is measured and monitored daily within Global Treasury. The daily liquidity report shows the Group's principal operating currencies of euro, sterling, US dollar and Polish zloty. Group ALCo and the Board receive monthly reports on the liquidity and funding position of the Group. Further information on liquidity risk can be found in note 61 to the financial statements.

3.6 Operational risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. It includes legal risk, but excludes strategic and reputational risk. In essence, operational risk is a broad canvas of individual risk types which include information technology and business continuity risk, internal and external fraud risk and fiduciary and legal risk.

Further information and analysis is available in the 2009 Annual Financial Report on the Group's website (www.aibgroup.com).

Risk identification and assessment

Risk and Control Self-Assessment ('self-assessment') is a core process in the identification and assessment of operational risk across the enterprise. The process serves to ensure that key operational risks are proactively identified, evaluated, monitored and reported, and that appropriate action is taken.

Self-assessments are completed at business unit level and are regularly reviewed and updated. Assurance processes are in place at divisional and enterprise level to ensure the completeness and robustness of each business unit's self-assessment, and that appropriate attention is given to more significant risks.

Risk management and mitigation

Each business area is primarily responsible for managing its own operational risks. An overarching Group Operational Risk Management (“ORM”) policy is in place, which has established an effective and consistent approach to Operational Risk Management across the enterprise. The Group ORM policy is also supported by a range of specific policies addressing issues such as new product and initiative approval, information security, and business continuity management.

An important element of the Group’s operational risk management framework is the ongoing monitoring through self-assessment of risks, control deficiencies and weaknesses, the tracking of incidents and loss events and the use of a structured ‘lessons learned’ process to ensure that, once identified, control deficiencies are communicated and remedied across the Group. The role of Group ORMCo is to review and coordinate operational risk management activities across the Group including setting policy and promoting best practice disciplines.

The Group takes an end-to-end approach to internal controls in order to make sure that all components, taken together, deliver the control objectives of key risk management processes.

In addition, an insurance programme is in place, including a self insured retention, to cover a number of risk events which would fall under the operational risk umbrella. These include financial lines policies (Comprehensive crime/Computer crime; Professional indemnity/Civil liability; Employment practices liability; Directors and officers liability) and a suite of general insurance policies to cover such things as property and business interruption, terrorism, combined liability and personal accident.

Risk monitoring and reporting

The primary objective of the operational risk management reporting and control process within the Group is to provide timely, pertinent operational risk information to the appropriate management level so as to enable appropriate corrective action to be taken and to resolve material incidents which have already occurred. A secondary objective is to provide a trend analysis on operational risk and incident data for the Group. The reporting of operational incidents, trend data, key risk indicators and outstanding audit issues at Group ORMCo supports these two objectives. In addition, the Board, Group Audit Committee and the RMC receive summary information on significant operational incidents on a regular basis.

3.7 Regulatory compliance risk

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

Risk identification and assessment

The scope of the Regulatory Compliance function relates to ‘conduct of business’ compliance obligations, including anti-money laundering and regulation on privacy and data protection. The identification, interpretation and communication roles relating to other legal and regulatory obligations have been assigned to functions with specialist knowledge in those areas. For example, employment law is assigned to Human Resources, taxation law to Group Taxation and prudential regulation to the Finance and Risk functions.

Regulatory Compliance undertakes a six-monthly assessment of the key compliance risks at divisional and enterprise level. The significance of compliance risks, its potential impact on the business and the effectiveness of management controls to mitigate these risks are assessed. These reviews of compliance risks also take a forward looking view of the compliance risks facing the Group, anticipating upstream risks in the form of new regulations, increased regulatory scrutiny and the increasing demands of stakeholders.

The divisional risks are discussed and agreed at divisional management boards. These are collated and processed by Regulatory Compliance into an overall enterprise-wide review of compliance risks. This is reviewed at the RMC and ultimately the Group Audit Committee. The Regulatory Compliance function supports and validates this approach by operating a risk framework model that is used in collaboration with business units to identify, assess and manage key compliance risks at business unit level. These risks are incorporated into the Operational Risk Self Assessment Risk Templates (“SARTs”) for the relevant business unit.

Risk management and mitigation

The Board, operating through the Audit Committee, has approved the Group's compliance policy and the mandate for the Regulatory Compliance function. The Audit Committee reviews the Group's key compliance risks on a six monthly basis to assess the extent to which they are being managed effectively.

Management is responsible for ensuring that the Group complies with its regulatory responsibilities. GEC's responsibilities in respect of compliance include the establishment and maintenance of the framework for internal controls and the control environment in which compliance policy operates thereby ensuring that Regulatory Compliance is suitably independent from business activities and that it is adequately resourced.

The Regulatory Compliance function is specifically responsible for:

- Independently identifying, assessing and monitoring compliance risks faced by the Group;
- Advising and reporting to the RMC, divisional boards and the Board of Directors (through the Audit Committee) on the effectiveness of the processes established to ensure compliance with laws and regulations within its scope;
- Providing advice and guidance to management and staff on compliance risks within its scope and on appropriate policies and procedures to mitigate these risks; and
- Providing a monitoring capability for 'non-conduct of business' compliance risks in areas of taxation law, company law, employment law, environmental law, and health and safety law on a risk prioritised basis.

Regulatory Compliance is an enterprise-wide function headed by the Group General Manager, Regulatory and Operational Risk who reports to the Group Chief Risk Officer and independently to the Chairman of the Audit Committee. The primary role of the Regulatory Compliance function is to provide direction and advice to enable management to discharge its responsibility for managing the Group's compliance risks.

Regulatory Compliance is also mandated to conduct investigations of possible breaches of compliance policy and to appoint outside legal counsel or other specialist external resources to perform this task if appropriate.

The principal compliance risk mitigants are risk identification, assessment, measurement and the establishment of suitable controls at business level. In addition, the Group has insurance policies that cover a number of risk events which fall under the regulatory compliance umbrella.

Risk monitoring and reporting

Regulatory Compliance undertakes risk-based monitoring of compliance with relevant policies, procedures and regulatory obligations. Monitoring can be undertaken by either dedicated compliance monitoring teams, front-line quality assurance functions at the direction of the compliance function, or in the case of the Capital Markets division by the business unit compliance officers.

Risk prioritised annual compliance monitoring plans are prepared based on the risk assessment process. Monitoring is undertaken both on a business unit and a process basis. The annual monitoring plan is reviewed regularly, and updated to reflect changes in the risk profile from emerging risks, changes in risk assessments and new regulatory 'hotspots'. Issues emerging from compliance monitoring are escalated for management attention, and action plans and implementation dates are agreed. The implementation of these action plans is monitored by Regulatory Compliance.

4. Capital and capital management

The policy of the Group is to maintain adequate capital resources at all times, having regard to the nature and scale of its business and the risk inherent in its operations. It does this through an Internal Capital Adequacy Assessment Process (“ICAAP”). The overarching principle of the ICAAP is the explicit linkage between capital and risk; the adequacy of the Group’s capital is assessed on the basis of the risks to which it is exposed. This requires a clear assessment of the material risk profile of the Group, and a consideration of the extent to which identified risks, both individually and in aggregate, require capital to support them. In addition, the level of capital held by the Group is influenced by its target debt rating and minimum regulatory requirements.

The Board reviews and approves the Group’s capital plan on an annual basis. The capital planning process is fully integrated into the Group and divisional planning process. The capital plan considers the amount and type of capital the Group requires to support its business strategy and comply with regulatory requirements. It takes into consideration the results of stress tests, and considers strategies for hedging, releasing and raising capital in order to arrive at and maintain the Group’s desired capital profile. Stress testing, in the context of capital planning, is a technique used to evaluate the potential effect on an institution’s capital adequacy of a specific event or movement of a set of economic variables, and focuses on exceptional but plausible events. This means that an institution’s capital requirement can increase significantly during an economic stress despite a decrease in nominal exposures.

The Capital Requirements Directive

The Capital Requirements Directive (“CRD”), which was transposed into Irish law at the end of 2006, introduced some significant amendments to the capital adequacy framework. Its goal is to provide a greater link between the risk a bank faces and the capital it requires, and it does this in a number of ways. In terms of minimum capital requirements (‘Pillar 1’) it brings greater granularity in risk weightings under the standardised approach for credit risk, and introduces an explicit capital requirement for operational risk.

Perhaps the most significant amendment is the ability of banks to use the outputs of their own internal rating systems to calculate capital requirements for credit risk. This is known as the internal ratings based approach (“IRBA”). The IRBA allows banks to use their own estimates of the Probability of Default (“PD”) of their borrowers in the estimation of capital requirements. It can also allow banks to use their own estimates of a transaction’s Loss Given Default (“LGD”) and Exposure at Default (“EAD”). Use of IRBA is subject to supervisory approval, and is provided only to those banks that can demonstrate that their credit risk management and risk estimation processes meet the required minimum standards. Under Foundation IRB Approach banks are required to use the regulator’s prescribed LGD and other parameters required for calculating the risk weighted assets (“RWA”).

The CRD also introduces two additional ‘pillars’. Under Pillar 2 (‘supervisory review’) banks may estimate their own internal capital requirements through an ICAAP, which is subject to supervisory review and evaluation. Pillar 3 (‘market discipline’) involves the disclosure of a suite of qualitative and quantitative risk management information to the market.

Minimum regulatory capital requirement (Pillar 1)

The Group is subject to the requirements of the Financial Regulator. The Financial Regulator’s rules closely follow the provisions of the CRD, and apply a risk asset ratio framework to the measurement of capital adequacy.

The adequacy of the Group’s capital is assessed by comparing available regulatory capital resources with capital requirements. The minimum total capital ratio set by the CRD is 8% of which the tier 1 element must be at least 4%.

While the capital requirements for credit risk depend to a significant degree on the credit worthiness of the obligor, the CRD permits the use of different approaches to the calculation of RWA; the Standardised Approach and the Internal Ratings Based Approach. AIB Group uses a mix of Standardised and Internal Ratings Based Approaches for calculating capital requirements for credit risk. The capital requirement for market risk and operational risk is calculated according to the Standardised Approach.

The table below summarises the total exposures, based on Exposure at Default (“EAD”), the gross risk weighted assets and the minimum capital requirements at 31 December 2009 and 2008.

Table 1: Capital adequacy information

			2009
Total exposures (EAD), risk weighted assets and minimum capital requirement	Total exposures €m	Risk weighted assets €m	Minimum capital requirement €m
Credit risk - Standardised approach	54,594	48,013	3,841
Credit risk - IRB approach	134,566	62,363	4,989
Market risk – Standardised approach	N/A	2,196	176
Operational risk – Standardised approach	N/A	7,808	625
Total	189,158	120,380	9,631
			Restated ² 2008
Total exposures (EAD), risk weighted assets and minimum capital requirement	Total exposures €m	Risk weighted assets €m	Minimum capital requirement €m
Credit risk - Standardised approach	58,643	51,413	4,113
Credit risk - IRB approach	137,751	73,193	5,855
Market risk – Standardised approach	N/A	2,043	163
Operational risk – Standardised approach	N/A	7,250	580
Total	196,394	133,899	10,711

Table 1a: Market risk minimum capital requirement

	2009 €m	2008 €m
Market risk – minimum capital requirement		
Interest rate PRR ³	60	96
Equity rate PRR ²	6	8
Foreign exchange PRR ²	66	22
Investment firms	44	37
Total	176	163

Internal capital requirement (Pillar 2)

AIB Group defines its internal capital as the tier 1 capital required to protect it against severe unexpected losses that might put the solvency of AIB Group at risk. The internal capital requirement is determined by summing: - The minimum Pillar 1 regulatory requirement for credit risk and operational risk (calculated as 4% of RWA); the economic capital calculation for market risk in the trading book (VaR based); and the capital calculation for any other material risks that are deemed to warrant a specific capital requirement.

Target capital

For the year ended 31 December 2009 the Group managed and measured its own performance to a target Group tier 1 capital ratio at or above 8% (minimum policy ratio of 7.5% in 2008 and 2009).

Actual capital

This is the actual regulatory capital held for AIB Group, which at 31 December 2009 was € 12,315 million (2008: € 14,053 million). The capital adequacy information table sets out the components and calculation of the Group's tier 1 and total capital ratios under the CRD at 31 December 2009 and 31 December 2008.

Capital floor

AIB Group is subject to capital floors as determined by the Financial Regulator. The floors apply to both consolidated and individual subsidiary calculations, and are based on a percentage of the capital requirements that would have been calculated under the pre-CRD capital adequacy framework.

²Restated due to change in accounting policy for insurance contracts – see appendix 3

³Position risk requirement

Table 2: Capital adequacy information – components of capital base

	2009	Restated ⁴ 2008
	€m	€m
Tier 1		
Paid up share capital	329	294
Eligible reserves	9,952	8,600
Equity non-controlling interests in subsidiaries	437	354
Supervisory deductions from core tier 1 capital		
Intangible assets and goodwill	(1,044)	(1,378)
Other regulatory deductions	<u>(143)</u>	<u>(112)</u>
	(1,187)	(1,490)
Core tier 1 capital	9,531	7,758
Non-equity non-controlling interests in subsidiaries	189	990
Non-cumulative perpetual preferred securities	136	864
Reserve capital instruments	239	497
Supervisory deductions from tier 1 capital		
Expected loss adjustment	(1,101)	-
Securitisation positions	(205)	(100)
Holdings in other credit and financial institutions	<u>(119)</u>	<u>(72)</u>
	(1,425)	(172)
Total tier 1 capital	8,670	9,937
Tier 2		
Eligible reserves	239	232
IBNR provisions (Standardised portfolio)	510	536
Subordinated perpetual loan capital	189	692
Subordinated term loan capital	4,261	2,970
Supervisory deductions from tier 2 capital		
Expected loss adjustment	(1,101)	-
Securitisation positions	(205)	(100)
Holdings in other credit and financial institutions	<u>(119)</u>	<u>(72)</u>
	(1,425)	(172)
Total tier 2 capital	3,774	4,258
Gross capital	12,444	14,195
Supervisory deductions		
Holdings in insurance undertakings	(129)	(142)
Total capital	12,315	14,053
Risk weighted assets		
Credit risk	110,376	124,606
Market risk	2,196	2,043
Operational risk	7,808	7,250
Total risk weighted assets	120,380	133,899
Capital ratios		
Core tier 1	7.9%	5.8%
Tier 1	7.2%	7.4%
Total	10.2%	10.5%

The Group's capital ratios remained strong during 2009, primarily due to the € 3.5 billion National Pension Reserve Fund Commission ("NPRFC") investment in preference shares, with a core tier 1 ratio of 7.9%, a tier 1 ratio of 7.2% and a total capital ratio of 10.2% at 31 December 2009.

Core tier 1 capital was € 9.5 billion at 31 December 2009, compared with € 7.8 billion at 31 December 2008. The increase reflects the issue of € 3.5 billion non-cumulative preference shares to the NPRFC⁵, a gain of € 1.2 billion on the redemption of capital instruments⁶, offset by negative retentions and exchange rate and other movements totalling € 3.0 billion.

Tier 1 capital was € 8.7 billion at 31 December 2009, down from € 9.9 billion at 31 December 2008. The decrease reflects the movements described above offset by the reduction of € 1.8 billion in

⁴Restated due to change in accounting policy for insurance contracts - see appendix 3

⁵See note 49 of the 2009 Annual Financial Report

⁶See note 7 of the 2009 Annual Financial Report

tier 1 instruments arising from the capital exchange offering and increased supervisory deductions of € 1.3 billion arising from the deterioration in the credit portfolios⁷.

Tier 2 capital decreased by € 0.5 billion to € 3.8 billion in the period to 31 December 2009. The decrease reflects the additional supervisory deductions from tier 2 capital of € 1.3 billion and the redemption of perpetual subordinated liabilities of € 0.5 billion offset by the issue of € 1.2 billion⁸ of dated subordinated notes under the capital exchange² and exchange rate and other movements of € 0.1 billion.

⁷The supervisory deduction from tier 1 capital and tier 2 capital primarily relate to the expected loss adjustment together with capital requirements in respect of securitisation positions, both of which are deducted 50% from tier 1 capital and 50% from tier 2 capital. The expected loss adjustment is the excess of expected loss on the IRBA portfolios over the IFRS provision on the IRBA portfolios.

⁸See note 7 of the 2009 Annual Financial Report

5. Credit Risk

The Group's main source of income arises from granting credit. Accordingly this exposes it to its most significant risk, namely credit risk. As described in section 3.1, Credit Risk is the risk that a customer or counterparty will be unable or unwilling to meet a commitment that it has entered into and that the Group is unable to recover the full amount that it is owed through the realisation of any security interests. The most significant credit risks in AIB Group arise from traditional lending activities to customers and banks. Credit risk also arises through the use of derivatives, off-balance sheet guarantees and commitments and through the Group's trading and 'available for sale' portfolios of financial instruments. Capital requirements are based on the perceived level of risk of individual credit exposures.

The Capital Requirements Directive ("CRD") provides two approaches for the calculation of minimum regulatory capital requirements for credit risk;

- a) The Standardised Approach; and
- b) Internal Ratings Based Approach ("IRB Approach"), which can be sub divided into
 - i. Foundation Internal Ratings Based Approach ("Foundation IRB Approach");
 - ii. Advanced Internal Ratings Based Approach ("Advanced IRB Approach"); and
 - iii. Retail Internal Ratings Based Approach ("Retail IRB Approach").

Under the Standardised Approach, risk weightings for rated counterparties are determined on the basis of the external credit rating assigned to the counterparty. For non-rated counterparties and certain other types of exposure, regulatory-determined standardised risk weightings are used.

The IRB Approach allows banks, subject to regulatory approval, to use their own estimates of certain risk components to derive regulatory capital requirements for credit risk across different asset classes. The relevant risk components are probability of default ("PD"), loss given default ("LGD") and exposure at default ("EAD"). For non-retail exposures, there are two IRB approaches. Under the Foundation IRB Approach banks use their own estimate of PD, and regulatory estimates of LGD and EAD. Under the Advanced IRB Approach, banks use their own estimates of all three risk components. For retail exposures, there is only one IRB approach – this uses internal estimates of all three risk components.

Both Standardised and Foundation IRB exposures are assigned to exposures classes, in accordance with Articles 79 and 86 of the CRD. In relation to the Standardised Approach, AIB Group continues to introduce new rating models which result in reclassifications between exposure classes.

As at 31 December 2009, the Group uses a combination of Standardised and IRB Approaches for assessing its capital requirements for credit risk. It has received regulatory approval to use the Foundation IRB Approach for certain sovereign, bank and corporate exposures, and uses the Retail IRB Approach for certain residential mortgage exposures (henceforth, for ease of reference within this document, this combination of Foundation and Retail IRB approval will be referred to as approval to use a Foundation IRB Approach).

As at 31 December 2009, 43.5% (2008: 41.3%) of the Group's credit risk capital requirement has been calculated on the basis of the Standardised Approach, with the remainder calculated using the Foundation IRB Approach. Details of the approvals for Foundation IRB are set out in section 7. Capital requirements for portfolios where the Group is migrating to Foundation IRB over a timeframe agreed with the Financial Regulator are calculated using the Standardised Approach.

The Group's exposures under both Standardised and Foundation IRB approaches are set out in sections 6 and 7. Additional commentary on specific credit risks arising from certain transactions including derivative transactions, repurchase agreements and securitisations are set out in sections 10 and 11 of this document.

These disclosures have been provided on a Group consolidated basis and include assets which, as at 31 December 2009, were held for sale to NAMA. Further information and analysis is available in the 2009 Annual Financial Report, available on the Group website.

The following definitions apply to the tables throughout this document:

- a) The Group reports exposure values as Exposure at Default ("EAD").
- b) Total gross exposure is before Credit Risk Mitigation ("CRM"), Credit Conversion Factors ("CCFs") and offsets;
- c) Total exposure is after CRM, CCFs and after specific offsets;

- d) Items belonging to high risk categories include, subject to the discretion of competent authorities, exposures associated with particularly high risks such as investments in venture capital firms and private equity investments;
- e) Collective Investment Undertakings (“CIU”) include:
- i. undertakings where the sole object is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading; and
 - ii. units which are, at the request of the holders, repurchased or redeemed, directly or indirectly, out of those undertakings’ assets. Action taken by a CIU to ensure that the stock exchange value of its units does not vary significantly from their net asset value shall be regarded as equivalent to such repurchase or redemption.
- f) “Other items” refers to other assets including land and buildings, plant and machinery, other fixtures and fittings, tools and equipment, payments on account and tangible assets in the course of construction.

The capital requirements for exposures calculated under the Standardised Approach and Foundation IRB Approach and the related exposure values are set out in the following table.

Table 3: Total exposures (EAD) by exposure class and related minimum capital requirements

Exposure class	2009		2008	
	Total exposures €m	Minimum capital requirement €m	Total exposures €m	Minimum capital requirement €m
Standardised exposure class				
Central governments and central banks	620	-	133	-
Regional governments or local authorities	20	-	31	1
Administrative bodies and non-commercial undertakings	481	39	34	3
Institutions ⁹	29	1	504	33
Corporates	15,002	1,179	18,526	1,411
Retail	9,574	574	10,405	625
Secured on real estate property	22,658	1,573	24,127	1,693
Past due items ¹⁰	2,913	317	1,232	138
Items belonging to regulatory high risk categories	103	13	174	21
Collective investment undertakings	13	1	12	1
Other items	3,181	144	3,465	187
Total for Standardised Approach	54,594	3,841	58,643	4,113
Foundation IRB exposure class				
Central governments and central banks	21,776	10	16,816	11
Institutions ¹	15,537	180	19,865	244
Corporates	65,043	4,145	70,611	5,170
Retail	25,876	406	22,773	276
Securitisation positions	6,326	247	7,679	154
Non-credit obligation assets	8	1	7	-
Total for Foundation IRB Approach	134,566	4,989	137,751	5,855
Total for Credit Risk	189,160	8,830	196,394	9,968

⁹Institutions exposure class predominantly relates to banks.

¹⁰The Basel standardised asset class past due items only includes exposures that are (a) standardised; (b) greater than 90 days past due or defaulted; and (c) impaired. A profile of contractually past due (but not impaired) facilities, for both the Standardised and Foundation IRB Approaches, is contained in table 14, set out in section 9.

6. Credit Risk – Standardised Approach

Exposures rated under Standardised Approach amounted to € 54,594 million, with a capital requirement of € 3,841 million as at 31 December 2009 (2008: exposures of € 58,643 million, capital requirement of € 4,113 million). This amounts to 43.5% (2008: 41.3%) of the total capital requirement for credit risk. The following tables analyse the Credit Risk Exposures under the Standardised Approach by sector on the following bases:

- a) Industry (table 4);
- b) Geographic (table 5); and
- c) Residual maturity (table 6).

Use of external credit ratings

AIB uses Standard and Poor's Rating Services, Moody's Investors Service and Fitch Ratings as its nominated External Credit Assessment Institutions ("ECAIs") for a small part of its credit risk corporate asset class exposures under the Standardised Approach (see also section 11).

Exposures to which credit ratings are assigned are mapped to risk weights using mapping guidelines issued by the Financial Regulator. These guidelines are identical to those issued by the Committee of European Banking Supervisors ("CEBS"). The externally rated credit risk exposures are not material and represent 1.8% of standardised exposures and 0.5% of the total (Standardised Approach and Foundation IRB Approach) credit risk exposures (2008: 2.4% and 0.7% respectively). Another immaterial portion has been rated using credit quality assessment steps. These relate to exposures where a preferential risk weight is applied to the exposures when there is no rating agency but other criteria is met to apply a risk bucket other than unrated.

Of the total exposures after credit risk mitigation amounting to € 54,594 million (2008: € 58,643 million), € 917 million (2008: € 1,424 million) are rated by ECAIs and € 78 million (2008: € 299 million) is rated using credit quality assessment steps. These are set out in tables 7 and 8 below.

Table 4: Industry distribution of credit exposures (EAD) – Standardised Approach

2009

Exposure class	Agriculture	Construction	Distribution	Energy	Financial	Home loans	Manufacturing	Other loans - personal	Other services	Property	Transport & communication	Bank, sovereign & public sector	Other	Total exposures
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Central governments and central banks	-	-	-	-	-	-	-	-	-	-	-	620	-	620
Regional governments or local authorities	-	-	-	-	-	-	-	-	-	-	-	20	-	20
Administrative bodies and non-commercial undertakings	-	-	-	-	-	-	-	-	-	-	-	481	-	481
Institutions	-	-	-	-	-	-	-	-	-	-	-	29	-	29
Corporates	711	671	2,107	158	1,168	15	1,264	1,294	4,907	1,915	553	-	239	15,002
Retail	871	445	876	21	68	802	361	4,561	807	493	269	-	-	9,574
Secured on real estate property ¹¹	86	1,247	534	32	315	5,308	528	183	669	13,715	41	-	-	22,658
Past due items	61	341	251	9	78	201	101	440	178	1,228	25	-	-	2,913
Items belonging to regulatory high risk categories	1	1	4	7	14	-	10	2	60	-	4	-	-	103
Collective investment undertakings	-	-	-	-	13	-	-	-	-	-	-	-	-	13
Other items	-	-	2	-	320	-	1	-	29	-	1	-	2,828	3,181
Total exposures	1,730	2,705	3,774	227	1,976	6,326	2,265	6,480	6,650	17,351	893	1,150	3,067	54,594

¹¹The total exposures (EAD) in the secured on real estate property exposure class includes a significant portion of property portfolios in AIB Bank UK, Capital Markets and CEE divisions, as well as residential mortgages in AIB Bank UK and CEE divisions.

Table 4: Industry distribution of credit exposures (EAD) – Standardised Approach

2008

Exposure class	Agriculture €m	Construction €m	Distribution €m	Energy €m	Financial €m	Home loans €m	Manufacturing €m	Other loans - personal €m	Other services €m	Property €m	Transport & communication €m	Bank, sovereign & public sector €m	Other €m	Total exposures €m
Central governments and central banks	-	-	-	-	-	-	-	-	-	-	-	133	-	133
Regional governments or local authorities	-	-	-	-	-	-	-	-	-	-	-	31	-	31
Administrative bodies and non-commercial undertakings	-	-	-	-	-	-	-	-	-	-	-	34	-	34
Institutions	-	-	-	-	-	-	-	-	-	-	-	504	-	504
Corporates	872	272	2,825	227	2,402	9	2,027	2,022	6,711	127	873	-	159	18,526
Retail	953	545	1,057	30	154	468	447	5,003	887	482	353	-	26	10,405
Secured on real estate property ¹²	1	2,375	92	-	30	5,120	5	19	45	16,440	-	-	-	24,127
Past due items	24	117	82	8	14	70	56	214	88	542	17	-	-	1,232
Items belonging to regulatory high risk categories	1	-	5	8	22	-	47	4	83	-	4	-	-	174
Collective investment undertakings	-	-	-	-	12	-	-	-	-	-	-	-	-	12
Other items	-	-	3	-	277	-	1	1	28	-	3	-	3,152	3,465
Total exposures	1,851	3,309	4,064	273	2,911	5,667	2,583	7,263	7,842	17,591	1,250	702	3,337	58,643

¹²The total exposures (EAD) in the secured on real estate property exposure class includes a significant portion of property portfolios in AIB Bank UK, Capital Markets and CEE divisions, as well as residential mortgages in AIB Bank UK and CEE divisions.

Table 5: Geographic¹³ distribution of credit exposures (EAD) – Standardised Approach

							2009	
Geography	Republic of Ireland	United Kingdom	Poland	United States of America	Rest of the world	Total exposures	Total gross exposures	Average exposures over the period
Exposure class	€m	€m	€m	€m	€m	€m	€m	€m
Central governments and central banks	614	-	-	-	6	620	620	416
Regional governments or local authorities	-	-	20	-	-	20	46	31
Administrative bodies and non-commercial undertakings	21	8	4	448	-	481	482	122
Institutions	2	16	4	1	6	29	169	84
Corporates	4,417	8,314	1,638	594	39	15,002	17,456	17,055
Retail	6,137	1,298	2,069	-	70	9,574	15,164	10,028
Secured on real estate property ¹⁴	5,240	10,827	5,253	708	630	22,658	23,361	23,360
Past due items	1,162	1,419	288	44	-	2,913	4,260	2,176
Items belonging to regulatory high risk categories	57	-	-	46	-	103	136	130
Collective investment undertakings	-	-	13	-	-	13	13	12
Other items	1,907	481	782	5	6	3,181	3,174	3,657
Total	19,557	22,363	10,071	1,846	757	54,594	64,881	57,871

¹³AIB Group monitors geographic breakdown based on the country of the borrower and the guarantor of the ultimate risk.

¹⁴The total exposures (EAD) in the secured on real estate property exposure class includes a significant portion of property portfolios in AIB Bank UK, Capital Markets and CEE divisions, as well as residential mortgages in AIB Bank UK and CEE divisions.

Table 5: Geographic¹⁵ distribution of credit exposures (EAD) – Standardised Approach

Geography							2008	
	Republic of Ireland	United Kingdom	Poland	United States of America	Rest of the world	Total exposures	Total gross exposures	Average exposures over the period ¹⁶
Exposure class	€m	€m	€m	€m	€m	€m	€m	€m
Central governments and central banks	99	34	-	-	-	133	133	407
Regional governments or local authorities	-	-	31	-	-	31	56	15
Administrative bodies and non-commercial undertakings	20	11	3	-	-	34	34	62
Institutions	8	6	484	-	6	504	646	653
Corporate	6,106	8,570	2,712	1,087	51	18,526	21,472	21,676
Retail	6,860	1,274	2,183	-	88	10,405	16,047	12,174
Secured on real estate property ¹⁷	5,920	11,790	4,606	1,144	667	24,127	25,717	28,230
Past due items	365	742	110	15	-	1,232	1,659	972
Items belonging to regulatory high risk categories	63	6	22	83	-	174	198	132
Collective investment undertakings	-	-	12	-	-	12	12	10
Other items	2,009	680	761	4	11	3,465	3,501	3,276
Total	21,450	23,113	10,924	2,333	823	58,643	69,475	67,607

¹⁵AIB Group monitors geographic breakdown based on the country of the borrower and the guarantor of the ultimate risk.

¹⁶Included in the calculation of 'average exposures for the period' for 2008 are exposures that were included under the Standardised Approach at the beginning of 2008 but received IRB approval during 2008. The 'average exposures for the period' are therefore reflective of movements to IRB of models approved during 2008.

¹⁷The total exposures (EAD) in the secured on real estate property exposure class includes a significant portion of property portfolios in AIB Bank UK, Capital Markets and CEE divisions, as well as residential mortgages in AIB Bank UK and CEE divisions.

Table 6: Residual maturity of credit exposures (EAD) – Standardised Approach

										2009
Exposure class	On demand	0 < 3 months	3 < 6 months	6 months < 1 year	1 < 3 years	3 < 5 years	5 < 10 years	10 years +	No maturity	Total exposures
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Central governments and central banks	-	620	-	-	-	-	-	-	-	620
Regional governments or local authorities	6	2	-	1	4	3	2	2	-	20
Administrative bodies and non-commercial undertakings	-	14	4	22	325	112	3	1	-	481
Institutions	16	6	-	-	4	3	-	-	-	29
Corporates	86	1,621	750	2,357	3,305	2,420	1,254	3,209	-	15,002
Retail	55	815	420	2,038	1,721	2,150	1,067	1,308	-	9,574
Secured on real estate property ¹⁸	433	3,150	1,279	2,459	3,456	4,383	1,654	5,844	-	22,658
Past due items	250	213	144	685	219	992	151	259	-	2,913
Items belonging to regulatory high risk categories	-	-	-	54	4	22	23	-	-	103
Collective investment undertakings	3	-	-	-	10	-	-	-	-	13
Other items	156	1	1	83	113	17	-	-	2,810	3,181
Total	1,005	6,442	2,598	7,699	9,161	10,102	4,152	10,623	2,812	54,594

										2008
Exposure class	On demand	0 < 3 months	3 < 6 months	6 months < 1 year	1 < 3 years	3 < 5 years	5 < 10 years	10 years +	No maturity	Total exposures
	€m	€m	€m	€m	€m	€m	€m	€m	€m	€m
Central governments and central banks	-	99	-	1	-	33	-	-	-	133
Regional governments or local authorities	6	1	-	7	10	5	2	-	-	31
Administrative bodies and non-commercial undertakings	-	-	-	-	24	6	4	-	-	34
Institutions	14	5	-	6	479	-	-	-	-	504
Corporates	529	1,566	756	3,138	3,497	3,022	2,533	3,485	-	18,526
Retail	62	798	530	2,187	1,813	2,499	1,159	1,357	-	10,405
Secured on real estate property ¹	414	3,000	1,522	2,270	5,115	4,145	2,205	5,456	-	24,127
Past due items	88	238	41	229	67	383	57	129	-	1,232
Items belonging to regulatory high risk categories	7	-	-	56	6	50	54	1	-	174
Collective investment undertakings	-	-	-	-	-	9	3	-	-	12
Other items	-	2	44	212	67	34	-	-	3,106	3,465
Total	1,120	5,709	2,893	8,106	11,078	10,186	6,017	10,428	3,106	58,643

¹⁸The total exposures (EAD) in the secured on real estate property exposure class includes a significant portion of property portfolios in AIB Bank UK, Capital Markets and CEE divisions, as well as residential mortgages in AIB Bank UK and CEE divisions.

Table 7: Total Exposure (EAD) value (after CRM) split by credit quality – Standardised Approach

Credit quality ¹⁹ assessment steps							2009		
	Step 1	Step 2	Step 3	Step 4	Step 5	Step 6	Total rated	Total unrated	Total
Central governments and central banks	620	-	-	-	-	-	-	-	620
Regional governments or local authorities	-	-	-	-	-	-	-	20	20
Administrative bodies and non-commercial undertakings	214	220	8	-	-	-	442	39	481
Institutions	1	-	-	-	-	-	-	28	29
Corporates ²⁰	93	232	143	26	-	-	494	14,508	15,002
Retail	-	-	-	-	-	-	-	9,574	9,574
Secured on real estate property	5	-	3	-	-	-	8	22,650	22,658
Past due items	-	-	-	-	-	5	5	2,908	2,913
Items belonging to regulatory high risk categories	-	-	-	-	32	14	46	57	103
Collective investment undertakings	-	-	-	-	-	-	-	13	13
Other items	-	-	-	-	-	-	-	3,181	3,181
Total	312	452	154	26	32	19	995	53,599	54,594

¹⁹The following ratings apply to the credit quality assessment steps as follows:

- Credit quality assessment step 1: AAA to AA (S&P / Fitch / DBRS); Aaa to Aa3 (Moody's)
- Credit quality assessment step 2: A+ to A- (S&P / Fitch / DBRS); A1 to A3 (Moody's)
- Credit quality assessment step 3: BBB+ to BBB- (S&P / Fitch / DBRS); Baa1 to Baa3 (Moody's)
- Credit quality assessment step 4: BB+ to BB- (S&P / Fitch / DBRS); Ba1 to B3 (Moody's)
- Credit quality assessment step 5: B+ to B- (S&P / Fitch / DBRS); B1 to B3 (Moody's)
- Credit quality assessment step 6: CCC+ and below (S&P / Fitch / DBRS); Caa1 and below (Moody's)

²⁰For the Standardised Approach, the total exposure after netting and volatility adjustments covered by eligible financial collateral is Nil.

Table 7: Total Exposure (EAD) value (after CRM) split by credit quality – Standardised Approach

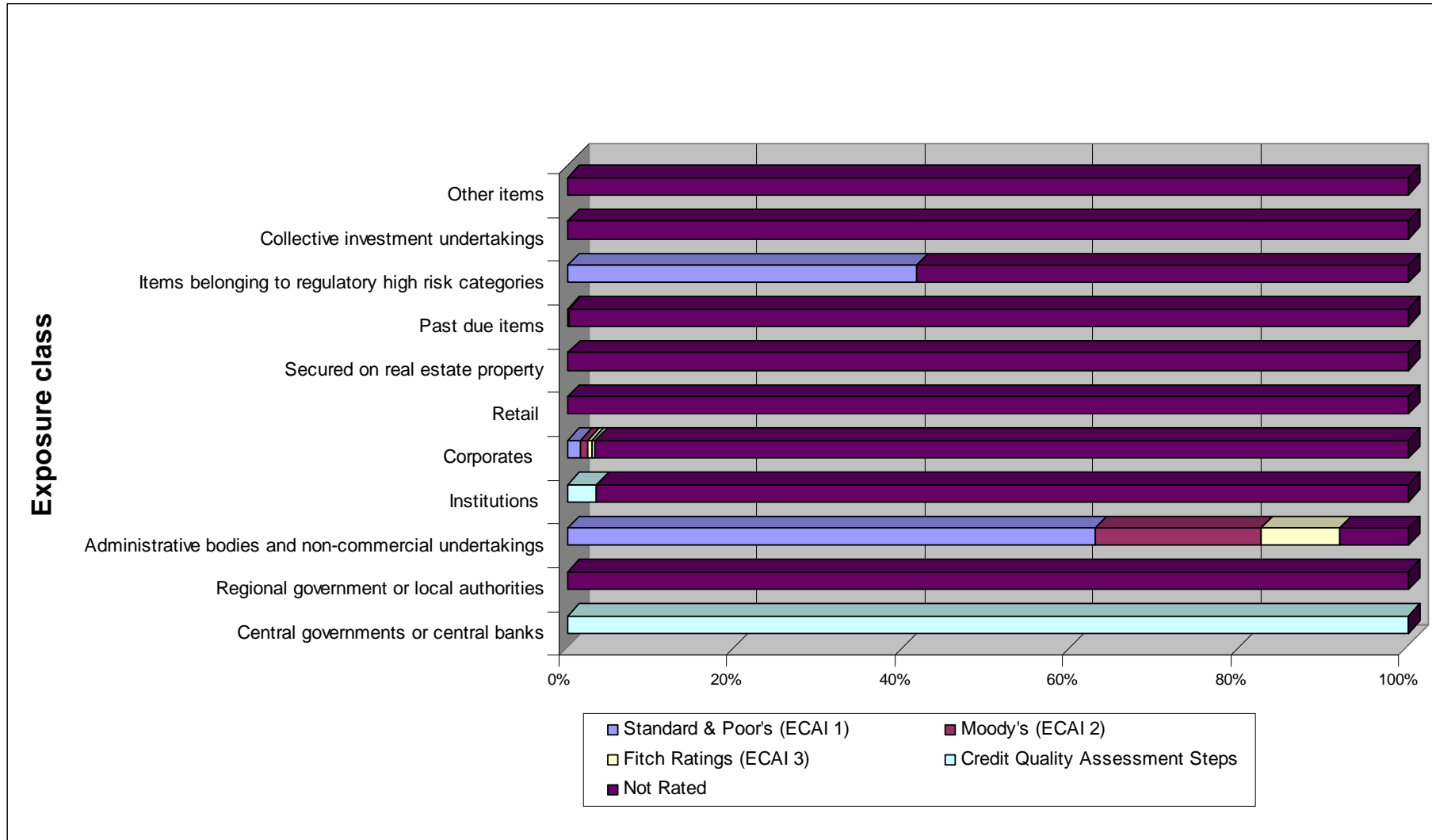
	2008								
Credit quality ²¹ assessment steps	Step 1	Step 2	Step 3	Step 4	Step 5	Step 6	Total rated	Total unrated	Total
Central governments and central banks	98	-	-	-	-	-	98	35	133
Regional governments or local authorities	-	5	-	-	-	-	5	26	31
Administrative bodies and non-commercial undertakings	21	-	-	-	-	-	21	13	34
Institutions	7	-	-	-	-	-	7	497	504
Corporates ²²	722	509	142	27	-	-	1,400	17,126	18,526
Retail	-	-	-	-	-	-	-	10,405	10,405
Secured on real estate property	47	7	17	1	-	1	73	24,054	24,127
Past due items	-	-	-	-	2	6	8	1,224	1,232
Items belonging to regulatory high risk categories	-	-	-	-	99	12	111	63	174
Collective investment undertakings	-	-	-	-	-	-	-	12	12
Other items	-	-	-	-	-	-	-	3,465	3,465
Total	895	521	159	28	101	19	1,723	56,920	58,643

²¹The following ratings apply to the credit quality assessment steps as follows:

- Credit quality assessment step 1: AAA to AA (S&P / Fitch / DBRS); Aaa to Aa3 (Moody's)
- Credit quality assessment step 2: A+ to A- (S&P / Fitch / DBRS); A1 to A3 (Moody's)
- Credit quality assessment step 3: BBB+ to BBB- (S&P / Fitch / DBRS); Baa1 to Baa3 (Moody's)
- Credit quality assessment step 4: BB+ to BB- (S&P / Fitch / DBRS); Ba1 to B3 (Moody's)
- Credit quality assessment step 5: B+ to B- (S&P / Fitch / DBRS); B1 to B3 (Moody's)
- Credit quality assessment step 6: CCC+ and below (S&P / Fitch / DBRS); Caa1 and below (Moody's)

²²For the Standardised Approach, the total exposure after netting and volatility adjustments covered by eligible financial collateral is €104 million, all of which relates to the Corporates exposure class.

Table 8: Standardised credit risk exposure class



7. Credit risk - Foundation Internal Ratings Based Approach

Exposures rated under Foundation IRB Approach amounted to € 134,566 million, with a capital requirement of € 4,989 million as at 31 December 2009 (2008: exposures of € 137,751 million, capital requirement of €5,855 million). This amounts to 56.5% (2008: 58.7%) of the total capital requirement for credit risk.

Regulatory approval and transition

As at 31 December 2009 and 2008, the Group has received approval from the Financial Regulator for use of the Foundation IRB Approach for the following portfolios and exposure classes:

Division	AIB Portfolio	Exposure class
AIB Bank ROI	Commercial / large SME Property Residential Mortgages	Corporates Corporates Retail
Capital Markets	Bank Corporates Not-for-profit Project finance Sovereign	Institutions Corporates Corporates Corporates Central governments and central banks
AIB Bank UK	Bank Sovereign	Institutions Central governments and central banks
Central & Eastern Europe	Bank Sovereign	Institutions Central governments and central banks

AIB monitors its roll-out plans to transition other standardised portfolios in the Group to the Foundation IRB Approach.

Governance of the rating process

AIB has a formalised governance framework around the entire internal ratings model process. The Credit Risk Measurement Committee is chaired by the Group Chief Risk Officer. Membership of this Committee includes executive director representation. The Board has designated the Credit Risk Measurement Committee as the body responsible for approval of material aspects of credit risk measurement systems and processes. The Committee's responsibilities include:

- ensuring that the credit risk rating models used in regulatory capital calculations comply with the requirements of the CRD;
- approval of Group standards for the development, validation, maintenance and use of credit risk rating models;
- approval of new credit risk rating models to be used in the estimation of minimum regulatory capital requirements, and approval of changes to these models;
- establishment and maintenance of governance structures and processes required for credit risk rating model development and validation; and
- confirmation that the requirements for independence in the above processes have been met.

Credit Risk Control function

The Credit Risk Control function within the Group is an integrated set of independent units and functions which share responsibility for key control aspects of the Group's rating systems. These responsibilities include rating model development, use, performance monitoring and oversight. The Credit Risk Control function supports risk management organisation and governance structures at Group and divisional level. The Group Chief Risk Officer and the Group Chief Credit Officer have primary responsibility for the Credit Risk Control function at group level. At divisional level, responsibility is divided between the Chief Risk Officer (rating model design and development, performance monitoring) and the Chief Credit Officer (rating system implementation), in line with credit

process responsibilities.

To ensure independence, credit risk management functions have separate reporting lines into the divisional Chief Risk Officers and the divisional Chief Credit Officers respectively. Divisional Chief Risk Officers report directly to the Group Chief Risk Officer and divisional Chief Credit Officers now report directly to the Group Chief Credit Officer. Divisional Chief Credit Officers also have a secondary reporting line into their divisional managing directors. Details of how credit is managed in AIB Group are outlined in section 3.

Use of rating models

Rating models and systems are core to credit and risk management in the Group. In recent years, the Group has invested significantly in the development and enhancement of these models, and has greatly expanded their use in credit processes. The outputs from Foundation IRB models play an essential role in a wide range of risk processes:

- a) Credit approval: Grades assigned by IRB risk models are a key input to the assessment of credit applications. Grades are also used in determining the size of delegated credit authorities. The outputs of the models are also used in assessing risk-return and pricing of loans;
- b) Risk management and decision-making processes: In the management of existing exposures grades, rating models are fundamental to management reporting and in determining the level and nature of management attention applied to exposures;
- c) Internal capital allocation: The outputs from IRB risk models are a core input to the Internal Capital Adequacy Assessment Process (“ICAAP”) including stress tests of capital adequacy;
- d) Annual planning: Risk forecasts based on the outputs of IRB models are embedded in the annual planning process.

Use of and process for recognising credit risk mitigation

When calculating the capital requirements for Foundation IRB Approach the Group takes account of collateral as a credit risk mitigant for residential real estate in its retail (home mortgage) portfolio but does not recognise credit risk mitigation techniques in the sovereign, institution and corporate exposure classes, with the exception of financial collateral.

The Group uses its own estimates of LGD in the calculation of risk weighted assets for exposures secured on residential real estate in its retail (home mortgage) portfolio. The Group's approach to taking, perfecting, valuing and monitoring real estate collateral is consistent with its broad framework for credit risk mitigation as described in section 8.

Internal ratings process by exposure class

The following tables set out the divisional analysis split out by portfolio for the exposure classes (a) Corporates; (b) Central governments and central banks; (c) Institutions; and (d) Retail rated under the Foundation IRB Approach. All of the PD estimates attached to the internal rating models described below are calibrated on a “*through the cycle*” basis.

(a) Corporates

The following portfolios within the Group's IRB Approach approval are treated under the corporates exposure class:

AIB Division	AIB Portfolio	Portfolio description
AIB Bank ROI	Commercial / large SME	Predominantly commercial business - all sectors except property.
AIB Bank ROI	Property	Property investment or development exposures where such exposures constitute more than 50% of total exposure to the borrower. Includes buy-to-let exposures where there are five or more buy-to-lets.

AIB Division	AIB Portfolio	Portfolio description
Capital Markets	Corporate	Companies that are engaged in the provision of goods or services with the intention of generating profit for the owners. Excluded from this category are: a) Financial service providers; b) Special purpose entities that do not have a diversified income stream; and c) Special purpose entities set up to facilitate securitisations.
Capital Markets	Not-for-profit	Exposures to not-for-profit entities in Allied Irish America.
Capital Markets	Project finance	Long-term loans made to projects in the energy, infrastructure and transportation sectors in Europe, North America, Middle East and Asia-Pacific.

Under the Foundation IRB Approach, internal rating models are used to assign corporate obligors to borrower grades, to which estimates of PD are attached. The Group uses regulatory LGD and EAD measures in calculating risk weighted assets.

The ratings methodology and criteria used in assigning borrowers to grades vary across the five models, but all five models use a combination of statistical analysis (using both financial and non-financial inputs) and expert judgement. PDs are calibrated on the basis of both internal and external available loss data and through benchmarking. External ratings, where available, play a role in both the assignment and calibration process, but their role is that of one factor amongst several others. The definition of default used for all five portfolios is consistent with the CRD definition. The Group's validation processes are rigorous. They test, *inter alia*, the rank ordering of borrowers in terms of probability of default, the stability of the ratings, the stability of the portfolio and the probability of default estimates.

(b) Central governments and central banks

The following portfolios within the Group's IRB Approach approval are treated under the central governments and central banks exposure class:

AIB Division	AIB Portfolio	Portfolio description
Capital Markets	Sovereign	Central governments Central banks Other specified multinational development banks and international organisations
AIB Bank UK	Sovereign	Central governments Central banks Other specified multinational development banks and international organisations
Central & Eastern Europe	Sovereign	Central governments Central banks Other specified multinational development banks and international organisations

Under the Foundation IRB Approach, internal rating models are used to assign central governments and central banks obligors to borrower grades, to which estimates of PD are attached. The Group uses regulatory LGD and EAD measures in calculating risk weighted assets.

Ratings are assigned on the basis of expert judgement, based upon perceived political risk, government policy risk, economic policy and external liquidity risk. PDs are calibrated on the basis of expert judgement, benchmarked to available external ratings. The definition of default is consistent with the CRD definition.

(c) Institutions

The following portfolios within the Group's IRB Approach approval are treated under the institutions exposure class:

AIB Division	AIB Portfolio	Portfolio description
Capital Markets	Bank	Banks Securities firms subject to the same regulation as banks
AIB Bank UK	Bank	Banks Securities firms subject to the same regulation as banks
Central & Eastern Europe	Bank	Banks Securities firms subject to the same regulation as banks

Under the Foundation IRB Approach, internal rating models are used to assign institutional obligors to borrower grades, to which estimates of PD are attached. The Group uses regulatory LGD and EAD measures to calculate risk weighted assets.

Ratings are assigned on the basis of a hybrid model (a statistical model or scorecard with some expert judgement). External ratings for the country of domicile are used to establish a 'country ceiling' on the rating, and as an input into the quantitative score. Due to the lack of internal default data, PDs are calibrated to an equivalent external rating grade. The definition of default is consistent with that used by the rating agencies, which in general is considered to occur at an earlier stage than that defined by the CRD and hence considered to be more conservative.

(d) Retail

The following portfolios within the Group's IRB Approach approval are treated under the retail exposure class:

Division	AIB Portfolio	Portfolio description
AIB Bank ROI	Branch originated - home mortgages	Home mortgage lending and first four buy-to-let
AIB Bank ROI	Mortgages - finance and leasing	Home mortgage lending and first four buy-to-let

Under the IRB Approach for retail, the Group uses its own estimates of PD, LGD and EAD in calculating risk weighted assets for residential mortgages originated in Ireland. The rating methodology is primarily statistical, with limited use of expert judgement. Application and behavioural scorecards are used. PDs and LGDs are calibrated on the basis of internal data, supplemented with benchmarking to external sources. EAD is calculated both on drawn facilities and on 'pipeline' business (mortgages which have been sanctioned but not yet drawn down). The definition of default is consistent with the CRD definition of default.

During 2009, exposures in AIB Bank ROI with a book value of € 1.7 billion, previously graded on the Property model and included in the Corporates exposure class, were transferred to the Mortgage model and are now included in the Retail exposure class.

There were no changes to the calibrations of any of the rating models in 2009.

Table 9: Industry distribution of credit exposures (EAD) - Foundation IRB Approach

2009

Exposure class	Central governments and central banks	Institutions	Corporates	Retail	Securitisation positions	Non-credit obligation assets	Total
Sector	€m	€m	€m	€m	€m	€m	€m
Agriculture	-	-	672	-	-	-	672
Construction ²³	-	-	13,425	-	-	1	13,426
Distribution	-	-	8,644	-	-	3	8,647
Energy	-	-	2,274	-	-	-	2,274
Financial	-	-	503	-	4,885	-	5,388
Home loans	-	-	1,574	25,876	-	-	27,450
Manufacturing	-	-	5,103	-	-	-	5,103
Other loans – personal	-	-	1,861	-	-	-	1,861
Other services	-	-	10,134	-	1,432	1	11,567
Property ¹	-	-	17,790	-	9	-	17,799
Transport and communication	-	-	3,063	-	-	3	3,066
Bank, sovereign & public sector entities	21,776	15,537	-	-	-	-	37,313
Total exposure	21,776	15,537	65,043	25,876	6,326	8	134,566

2008

Exposure class	Central governments and central banks	Institutions	Corporates	Retail	Securitisation positions	Non-credit obligation assets	Total
Sector	€m	€m	€m	€m	€m	€m	€m
Agriculture	-	-	918	-	-	-	918
Construction ¹	-	-	11,143	-	-	1	11,144
Distribution	-	-	8,868	-	-	2	8,870
Energy	-	-	2,659	-	-	1	2,660
Financial	-	-	685	-	5,716	-	6,401
Home loans	-	-	2,983	22,773	9	-	25,765
Manufacturing	-	-	6,420	-	-	1	6,421
Other loans – personal	-	-	2,902	-	-	-	2,902
Other services	-	-	11,387	-	1,954	1	13,342
Property ¹	-	-	19,581	-	-	-	19,581
Transport and communication	-	-	3,065	-	-	1	3,066
Bank, sovereign & public sector entities	16,816	19,865	-	-	-	-	36,681
Total exposure	16,816	19,865	70,611	22,773	7,679	7	137,751

²³The significant majority of total exposures (EAD) under the construction and property sector codes represent property exposures in AIB Bank ROI which are graded through the approved Foundation IRB Approach property model.

Table 10: Geographic²⁴ distribution of credit exposures (EAD) - Foundation IRB Approach

								2009
Geography	Republic of Ireland	United Kingdom	Poland	United States of America	Rest of the World	Total exposures ²⁵	Total gross exposures ²	Average exposures over the period
Exposure Class	€m	€m	€m	€m	€m	€m	€m	€m
Central governments and central banks	12,754	5,280	3,567	162	13	21,776	25,148	19,279
Institutions	14,095	601	196	416	229	15,537	31,009	17,532
Corporates	56,268	1,608	-	6,084	1,083	65,043	68,027	68,468
Retail ²⁶	25,876	-	-	-	-	25,876	26,148	24,387
Securitisation positions	5,891	-	-	435	-	6,326	6,324	6,906
Non-credit obligation assets	8	-	-	-	-	8	8	7
Total	114,892	7,489	3,763	7,097	1,325	134,566	156,664	136,579

								2008
Geography	Republic of Ireland	United Kingdom	Poland	United States of America	Rest of the World	Total exposures ²	Total gross exposures ²	Average exposures over the period ²⁷
Exposure Class	€m	€m	€m	€m	€m	€m	€m	€m
Central governments and central banks	10,540	2,706	3,570	-	-	16,816	16,411	12,612
Institutions	18,174	758	552	379	2	19,865	29,622	21,000
Corporates	60,002	1,902	-	7,506	1,201	70,611	74,098	66,914
Retail ³	22,773	-	-	-	-	22,773	23,145	17,566
Securitisation positions	7,143	-	-	536	-	7,679	7,679	5,370
Non-credit obligation assets	6	1	-	-	-	7	7	7
Total	118,638	5,367	4,122	8,421	1,203	137,751	150,962	123,469

²⁴AIB Group monitors geographic breakdown based on the country of the borrower and the guarantor of the ultimate risk.

²⁵Certain bank exposures (within institutions asset class) are covered by a sovereign guarantee. In such cases a substitution approach is applied. The total gross exposures covered under the sovereign guarantee take the PD of the sovereign, thus attracting a lower risk weight, and are then categorised as a total exposure under the central governments and central banks asset class. Any total gross exposures not covered by the guarantee remain within the institution asset class (and the PD of the institution applies). The increase in total exposure under the central governments and central banks asset class reflects the amount covered by the sovereign guarantee.

²⁶All exposures under the IRB Approach for retail are secured by real estate collateral and represent the residential mortgage portfolio in the Republic of Ireland.

²⁷Included in the calculation of average exposures for the period are exposures that were included under the Standardised Approach at the beginning of 2008 but which received Foundation IRB approval during 2008. The average exposures for the period may therefore be reflective of movements to Foundation IRB of models approved during the year.

Table 11: Residual maturity of credit exposures (EAD) – Foundation IRB Approach

							2009
Residual maturity	Central governments and central banks €m	Institutions €m	Corporates €m	Retail €m	Securitisation positions €m	Non-credit obligation assets €m	Total €m
On demand	1,081	5	1,989	31	-	-	3,106
< 3 months	6,565	3,340	10,841	249	-	2	20,997
3 < 6 months	962	1,292	2,531	545	-	1	5,331
6 months < 1 year	1,703	1,611	17,311	360	9	2	20,996
1 < 3 years	4,555	5,247	11,499	578	61	2	21,942
3 < 5 years	3,711	1,718	8,331	396	282	1	14,439
5 < 10 years	2,233	1,871	4,622	1,611	532	-	10,869
10 years +	966	453	7,919	22,106	5,442	-	36,886
Total	21,776	15,537	65,043	25,876	6,326	8	134,566

							2008
Residual maturity	Central governments and central banks €m	Institutions €m	Corporates €m	Retail €m	Securitisation positions €m	Non-credit obligation assets €m	Total €m
On demand	2,439	925	1,367	-	-	-	4,731
< 3 months	1,511	2,360	15,417	153	9	1	19,451
3 < 6 months	449	1,212	3,532	553	19	1	5,766
6 months < 1 year	1,348	1,752	9,809	434	2	1	13,346
1 < 3 years	3,982	7,175	11,557	555	172	4	23,445
3 < 5 years	3,007	3,145	12,094	427	189	-	18,862
5 < 10 years	2,233	2,760	7,264	1,324	967	-	14,548
10 years +	1,847	536	9,571	19,327	6,321	-	37,602
Total	16,816	19,865	70,611	22,773	7,679	7	137,751

Foundation IRB obligor grades

For the purpose of calculating credit risk and ultimately its capital requirement using the Foundation IRB Approach, AIB has allocated all relevant exposures to obligor grades and an associated PD. These obligor grades are a risk category within the Group's rating systems. An obligor grade is assigned to obligors on the basis of rating criteria within each rating model from which estimates of probability of default are derived. These rating models have been calibrated at an individual business unit level. These individual rating models continue to be refined and recalibrated based on experience.

For the purposes of aggregate reporting, the Group uses a 13 point ratings masterscale which provides a common and consistent framework for aggregating, comparing and reporting exposures across all lending portfolios. The ratings masterscale is PD based. Under the ratings masterscale:

- Grades 1 – 3 would typically include strong corporate and commercial lending combined with elements of the retail portfolios and residential mortgages;
- Grades 4 – 10 would typically include new business written and existing satisfactorily performing exposures across all portfolios. The lower end of this category (grade 10) includes a portion of the Group's criticised loans (i.e. loans requiring additional management attention over and above that normally required for the loan type);
- Grades 11 – 13 contains the remainder of the Group's criticised loans, including impaired loans, together with loans written at a high PD where there is a commensurate higher margin for the risk taken.

Table 12 sets out the analysis of exposure classes by obligor grade, within the Foundation IRB Approach for the Group, excluding the securitisations (amounting to € 6,326 million), which are analysed in greater detail in section 11.

Table 12: Foundation IRB - Obligor grade disclosures (excluding securitisations)
2009

Obligor grade	Central Government & central banks		Institutions		Retail	
	Exposure value (EAD) ¹	Exposure-weighted average risk weight	Exposure value (EAD) ¹	Exposure-weighted average risk weight	Exposure value (EAD) ¹	Exposure-weighted average risk weight
	€m	%	€m	%	€m	%
Grade 1 - 3	21,776	1%	15,501	14%	14,175	3%
Grade 4 - 10	-	-	7	122%	10,187	23%
Grade 11 - 13	-	-	29	-	1,514	144%
Total	21,776	1%	15,537	14%	25,876	20%

Obligor grade	Corporates		Non-credit obligation assets		Total Foundation - IRB ²	
	Exposure value (EAD) ¹	Exposure-weighted average risk weight	Exposure value (EAD) ¹	Exposure-weighted average risk weight	Exposure value (EAD) ¹	Exposure-weighted average risk weight
	€m	%	€m	%	€m	%
Grade 1 - 3	6,041	28%	-	-	57,493	8%
Grade 4 - 10	37,894	102%	8	100%	48,096	85%
Grade 11 - 13	21,108	55%	-	-	22,651	61%
Total	65,043	80%	8	100%	128,240	46%

2008

Obligor grade	Central Government & central banks		Institutions		Retail	
	Exposure value (EAD) ¹	Exposure-weighted average risk weight %	Exposure value (EAD) ¹	Exposure-weighted average risk weight %	Exposure value (EAD) ¹	Exposure-weighted average risk weight %
	€m	%	€m	%	€m	%
Grade 1 - 3	16,816	1%	19,822	11%	12,769	10%
Grade 4 - 10	-	-	11	140%	9,279	22%
Grade 11 - 13	-	-	32	0%	725	130%
Total	16,816	1%	19,865	11%	22,773	15%

Obligor grade	Corporates		Non-credit obligation assets		Total Foundation - IRB ³	
	Exposure value (EAD) ¹	Exposure-weighted average risk weight %	Exposure value (EAD) ¹	Exposure-weighted average risk weight %	Exposure value (EAD) ¹	Exposure-weighted average risk weight %
	€m	%	€m	%	€m	%
Grade 1 - 3	8,598	33%	-	-	58,005	10%
Grade 4 - 10	57,032	95%	7	100%	66,329	85%
Grade 11 - 13	4,981	148%	-	-	5,738	145%
Total	70,611	92%	7	100%	130,072	54%

¹Includes EAD in relation to impaired loans.

²Excludes securitisation positions of €6,326 million.

³Excludes securitisation positions of €7,679 million.

Table 13: Retail Foundation IRB Approach

			2009
			Retail
Obligor grade	Exposure value (EAD)		Exposure-weighted average LGD
	€m		%
Grade 1 - 3	14,175		20%
Grade 4 - 10	10,187		23%
Grade 11 - 13	1,514		24%
Total	25,876		22%
			2008
			Retail
Obligor grade	Exposure value (EAD)		Exposure-weighted average LGD %
	€m		%
Grade 1 - 3	12,769		20%
Grade 4 - 10	9,279		22%
Grade 11 - 13	725		24%
Total	22,773		21%

8. Credit Risk Mitigation

Within both the Standardised and Foundation IRB Approaches, an important element in managing exposure to credit risk for AIB Group is the use of Credit Risk Mitigation (“CRM”) techniques. However AIB takes limited account of CRM in its calculation of minimum Pillar 1 capital.

AIB takes collateral in support of its lending activities when it is deemed appropriate and has a set of written policies and procedures in place to guide lenders in the assessment, valuation and taking of such collateral. In some circumstances, depending on the customer standing and/or the nature of the product AIB may lend on an unsecured basis.

The main types of collateral for loans and receivables to customers are as follows:

- Retail mortgages: The Group takes collateral in support of lending transactions for the purchase of residential property. There are clear policies in place which set out the type of property acceptable as collateral and the relationship of loan to property value. All properties are required to be fully insured and be subject to a legal charge in favour of the Group.
- Corporate and commercial lending: For property related lending, it is normal practice to take a charge over the property being financed. This includes investment and development properties. For non-property related lending, collateral typically includes a charge over business assets such as stock and debtors but which may also include property. In some circumstances, personal guarantees supported by a lien over personal assets are also taken as security.

Cross guarantees from companies within a connected group may also be taken to facilitate cross collateral cover. AIB rarely uses credit default swaps to mitigate credit risk. In assessing and approving overall credit limits for borrowers or groups of borrowers, the levels of guarantees given by such borrowers to third parties are taken into consideration. AIB monitors the nature and value of collateral by type, geography and sector.

The Group enters into master netting agreements with counterparties, to ensure that if an event of default occurs, all amounts outstanding with those counterparties will be settled on a net basis.

For the Standardised Approach the total exposure after netting and volatility adjustments covered by eligible financial collateral is Nil (2008: € 104 million, all of which relates to the corporate exposure class). For the Foundation IRB Approach the total exposure after netting and volatility adjustments covered by eligible financial collateral is € 681 million (2008: € 865 million), all of which relates to the institutions exposure class. Further information in relation to CRM framework is discussed within section 3.1. There is also more information in relation to repurchase transactions in section 10 Counterparty credit risks.

9. Credit Risk - Impairment

Criticised loans

Criticised loans are loans requiring additional management attention over and above that normally required for the loan type. This includes impaired loans.

Impairment

A financial asset or portfolio of financial assets is impaired and impairment losses are incurred if, and only if:

- a) there is objective evidence of impairment as a result of one or more loss events that occurred after the initial recognition of the asset on or before the balance sheet date, ('a loss event'); and
- b) that loss event or events has had an impact such that the estimated present value of future cash flows is less than the current carrying value of the financial asset, or portfolio of financial assets.

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

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

Determining impairment provisions and value adjustments

The Group first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (i.e. individually insignificant). If the Group determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and includes these performing assets under the collective incurred but not reported ("IBNR") assessment. Assets that are individually assessed for impairment and for which an impairment loss is, or continues to be recognised are not included in a collective assessment of impairment. For loans and receivables and assets held to maturity, the amount of impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the asset's effective interest rate. The amount of the loss is recognised using an allowance account and is included in the income statement.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflects the cash flows that may result from foreclosure, costs for obtaining and selling the collateral, whether or not foreclosure is probable.

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

Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of the contractual cash flows of the assets in the group and historical loss experience for assets with credit risk characteristics similar to those in the group. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current

conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not currently exist.

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

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

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

Assets acquired in exchange for loans and receivables in order to achieve an orderly realisation are accounted for as a disposal of the loan and an acquisition of an asset. Any further impairment of the assets or business acquired is treated as an impairment of the relevant asset and not as an impairment of the original instrument.

In the case of equity instruments classified as available for sale, a significant or prolonged decline in the fair value of the instrument below its cost is considered in determining whether impairment exists. Where such evidence exists, the cumulative net loss that had been previously recognised directly in equity is removed from equity and recognised in the income statement. Reversals of impairment of equity shares are not recognised in the income statement and increases in the fair value of equity shares after impairment are recognised directly in equity.

In the case of debt instruments classified as available for sale, impairment is assessed based on the same criteria as for all other financial assets. Reversals of impairment of debt securities are recognised in the income statement.

Past due

When a borrower fails to make a contractually due payment, a loan is deemed to be *past due*. *Past due days* is the term used to describe the cumulative numbers of days a missed payment is overdue. Past due days commence from the close of business on the day on which a payment is due but not received. In the case of overdrafts, past due days are counted once a borrower:

- a) has breached an advised limit;
- b) has been advised of a limit lower than the then current outstanding; or
- c) has drawn credit without authorisation.

When a loan or exposure is past due, the entire exposure is reported as past due, not just the amount of any excess or arrears.

The figures reported in table 14 for past due are based on loans and receivables to customers (both standardised and IRB) and are in line with reporting under IFRS 7. These relate to loans and receivables to customers which are contractually past due but not impaired.

Renegotiated loans

Renegotiated loans are those facilities at the current reporting date that, during the financial year, have had their terms renegotiated resulting in an upgrade from 91+ days past due or impaired status to performing status such that if they were not renegotiated they would be otherwise past due or impaired. Renegotiated loans and receivables was € 4,459 million as at 31 December 2009.

Renegotiated loans were € 154 million as at 31 December 2008 which related to loans which had their terms renegotiated resulting in an upgrade from impaired status.

Table 14: Contractually past due - industry and geographic distribution

					2009
Industry	Past due 1 < 30 days €m	Past due 31 < 60 €m	Past due 61 < 90 days €m	Past due 91 days + €m	Total €m
Agriculture	134	36	15	14	199
Energy	3	7	-	1	11
Manufacturing	85	20	10	7	122
Construction and property	2,022	711	299	496	3,528
Distribution	297	165	63	62	587
Transport	56	23	4	6	89
Financial	32	8	1	3	44
Other services	255	74	21	47	397
Personal					
Home mortgages	417	184	94	132	827
Credit cards	68	20	11	8	107
Other personal	385	173	58	126	742
Total	3,754	1,421	576	902	6,653
Geography	€m	€m	€m	€m	€m
Republic of Ireland	3,177	1,257	510	815	5,759
United Kingdom	317	102	46	83	548
Poland	255	59	20	4	338
United States of America	-	3	-	-	3
Rest of the World	5	-	-	-	5
Total	3,754	1,421	576	902	6,653
					2008
Industry	Past due 1 < 30 days €m	Past due 31 < 60 €m	Past due 61 < 90 days €m	Past due 91 days + €m	Total €m
Agriculture	185	42	18	4	249
Energy	5	2	1	-	8
Manufacturing	78	18	13	4	113
Construction and property	3,813	912	541	147	5,413
Distribution	464	136	181	15	796
Transport	52	16	4	1	73
Financial	25	3	3	5	36
Other services	490	67	37	41	635
Personal					
Home mortgages	326	164	105	38	633
Other personal	667	165	58	29	919
Total	6,105	1,525	961	284	8,875
Geography	€m	€m	€m	€m	€m
Republic of Ireland	5,357	1,382	888	153	7,780
United Kingdom	463	92	59	117	731
Poland	279	47	14	1	341
United States of America	-	-	-	13	13
Rest of the World	6	4	-	-	10
Total	6,105	1,525	961	284	8,875

Table 15: Impaired exposures and provisions - industry and geographic distribution

2009

Industry	Loans and receivables to customers – gross of provisions	Impaired exposures	Specific balance sheet provisions	Specific provision charge for year
	€m	€m	€m	€m
Agriculture	2,289	134	57	38
Energy	1,748	38	13	17
Manufacturing	5,746	314	120	123
Construction and property	48,802	13,443	4,216	3,820
Distribution	12,540	1,362	481	448
Transport and communications	1,795	44	26	30
Financial	2,354	160	87	93
Other services	11,181	449	175	175
Home loans	33,225	603	122	102
Other loans - personal	8,441	775	419	307
Lease financing	1,681	131	78	6
Total	129,802	17,453	5,794	5,159
Geography	€m	€m	€m	€m
Republic of Ireland	91,587	14,922	4,950	4,497
United Kingdom	25,811	1,944	626	525
Poland	8,728	477	188	97
United States of America	2,570	42	6	11
Rest of the World	1,106	68	24	29
Total	129,802	17,453	5,794	5,159
			€m	€m
IBNR provision			1,358	191
Specific provision in relation to loans and receivables to banks			4	5
Total impairment provisions (specific and IBNR)			7,156	5,355

Table 15: Impaired exposures and provisions - industry and geographic distribution

2008

Industry	Loans and Receivables to customers – gross of provisions € m	Impaired exposures € m	Specific balance sheet provisions € m	Specific provision charge for year € m
Agriculture	2,537	88	54	14
Energy	2,080	42	12	9
Manufacturing	6,957	167	69	34
Construction and property	47,926	1,653	556	548
Distribution	13,055	266	114	66
Transport and communications	1,869	16	11	5
Financial	2,783	20	12	7
Other Services	12,446	125	60	33
Home loans	31,625	246	47	30
Other loans - personal	8,972	315	180	102
Lease financing	1,913	53	31	-
Total	132,163	2,991	1,146	848
Geography	€ m	€ m	€ m	€ m
Republic of Ireland	92,662	1,972	762	545
United Kingdom	26,072	689	228	232
Poland	8,688	250	137	52
United States of America	3,378	61	12	12
Rest of the World	1,363	19	7	7
Total	132,163	2,991	1,146	848
			€ m	€ m
IBNR provision			1,146	974
Specific provision in relation to loans and receivables to banks			2	-
Total impairment provisions (specific and IBNR)			2,294	1,822

Table 16: Movement in impairment provisions of loans and receivables

	2009		
	Specific € m	IBNR € m	Total € m
At 1 January	1,148	1,146	2,294
Exchange translation adjustments	10	21	31
Transfer between specific and IBNR provisions	5,164	(5,164)	-
Charge against income statement (see below)	-	5,355	5,355
Amounts written off	(520)	-	(520)
Recoveries of amounts written off in previous periods	6	-	6
Transfers out	(10)	-	(10)
At 31 December	5,798	1,358	7,156
			2008
	Specific € m	IBNR € m	Total € m
At 1 January	526	218	744
Exchange translation adjustments	(71)	(46)	(117)
Transfer between specific and IBNR provisions	848	(848)	-
Charge against income statement (see below)	-	1,822	1,822
Amounts written off	(166)	-	(166)
Recoveries of amounts written off in previous periods	11	-	11
At 31 December	1,148	1,146	2,294

The charge against income statement for 2009 of € 5,355 million comprises € 5,164 million of a specific provision charge for impaired loans and € 191 million of an incurred but not reported ("IBNR")

provision charge for perceived losses in the performing book. Further information and analysis is available in the 2009 Annual Financial Report on the Group's website (www.aibgroup.com).

Loss experience in the preceding period – Foundation IRB Approach

An analysis of the expected loss ("EL") and actual loss experience by exposure class for the year ended 31 December 2009 is outlined in table 17. The EL is the level of loss that was expected in 2009 in the performing book based on the grade profile and associated probability of default ("PD") of the relevant exposures at the end of 2008. The actual loss is the specific provision charged to the income statement for the year ended 31 December 2009 in relation to exposures newly impaired in the period and rated under the Foundation IRB approach. The models which were Foundation IRB approved at the end of 2008 were the Corporate and Institutional portfolio models and the Retail model for residential mortgages. No further models were approved for use under the Foundation IRB Approach in 2009.

Regulatory expected loss versus actual losses

In comparing the EL and the actual loss experience it is important to note that AIB Group uses 'through the cycle' PDs in its calculation of EL and capital requirements, while provisions are driven by accounting standards and are calculated at point in time. Whilst regulatory EL provides a view of the expected losses that are likely to emerge in the loan book within one year, recognising the grade profile of the book at the time at which the EL is estimated, it does not forecast changes that will emerge in the grade profile of the book in the relevant year, nor does it take into account any likely future changes in the credit environment.

AIB Group monitors actual default and loss experience on an ongoing basis and uses this information in its review of PD estimates used in its rating tools. The PD of an individual credit will change with its grade profile.

The excess of actual loss over expected loss as estimated by the corporate rating models in 2009 is principally due to the significant downgrades to impaired grade and the associated losses experienced in the Group's property related portfolios in AIB Bank ROI during 2009.

Table 17: Expected loss analysis – Foundation IRB Approach

Exposure class	2009	
	Expected loss ³¹ €m	Actual loss €m
Institutions	1	4
Corporates	573	3,598
Retail	38	57
Securitisation positions ³²	-	37
Total	612	3,696
Exposure class	Expected loss ¹ €m	Actual loss €m
Retail exposures secured by real estate collateral	38	57
Total retail	38	57

³¹Expected loss is derived at the end of the preceding year, i.e. as at 31 December 2008 and 31 December 2007.

³²Under the Foundation IRB Approach, rating agency ratings, as opposed to EL, are used in the determination of capital for securitisation positions. For this reason AIB Group does not calculate EL for securitisation positions.

Table 17: Expected loss analysis – Foundation IRB Approach

Exposure class	2008	
	Expected loss ¹ €m	Actual loss €m
Institutions	2	-
Corporates	308	455
Retail ¹	-	10
Securitisation positions ²	-	8
Total	310	473

Exposure class	2008	
	Expected loss ¹ €m	Actual loss €m
Retail exposures secured by real estate collateral	-	10
Total retail	-	10

The Group's risk weightings for Foundation IRB models as at 31 December 2009 and 31 December 2008 are detailed in the table below. These weightings are influenced by the grade profile and associated PD of the portfolios, having applied loss given defaults ("LGD") of 45% for all portfolios, with the exception of residential mortgages which had average LGDs of 22% and 21% applied as at 31 December 2009 and 31 December 2008 respectively.

Table 18: CRD risk weightings (as a percentage of EAD) for Foundation IRB models

Foundation IRB rating models	2009	2008
	%	%
AIB Bank ROI		
Property	126	102
Commercial	115	109
Mortgage	20	15
Capital Markets		
Corporates	89	86
Bank	15	15
Sovereign	1	1
Not-for-profit	25	29
Project finance	96	104

The amounts presented in the above table represent the CRD risk weightings as a percentage of EAD for the Foundation IRB portfolio, excluding the non-retail loans classified as defaulted as these loans influence the EL calculation and not the risk weighted assets calculation. Comparatives for 2008 have been restated to exclude the EAD in relation to defaulted loans.

The risk weightings in relation to the Mortgage model in AIB Bank ROI have not been restated as defaulted retail loans influence both the risk weighted asset and EL calculations.

The increases in the risk weightings as a percentage of EAD in the Property and Commercial models in AIB Bank ROI, reflect a deterioration of the grade profile of the performing book.

¹The Foundation IRB retail model was approved in May 2008; therefore there were no comparable EL figures at the end of 2007.

²Under the Foundation IRB Approach, rating agency ratings, as opposed to EL, are used in the determination of capital for securitisation positions. For this reason AIB Group does not calculate EL for securitisation positions.

10. Counterparty credit risks

Assigning internal capital and credit limits for counterparty credit exposure

The Group is predominately exposed to counterparty credit exposure through its portfolio of derivatives and repurchase agreements ('repos').

Derivatives

Credit exposure arises on derivative transactions as there is a risk that the counterparty to the contract defaults prior to its maturity. If at that time, the Group would incur a loss to replace the contract this gives rise to a claim on the counterparty.

The credit exposure on derivatives is managed in the same way as other types of credit exposure. The Group applies the same credit control and risk management policies as relate to counterparty credit approval, limit setting and monitoring procedures.

Counterparty Credit Exposure ("CCE") consists partly of current replacement cost (or mark-to-market) of the contracts and partly of potential future exposure. The potential future exposure component is an estimation which reflects possible changes in market values during the remaining life of the individual contract. The CCE for an individual counterparty will take into account the existence of valid bilateral netting or collateral agreements, where these are in place.

AIB applies the simplified method for calculating exposure amounts for the purposes of calculating internal capital on counterparty credit exposure for derivatives.

Pre-settlement CCE limits must be approved in advance of any transactions being entered into by the appropriate credit approval authority. This forms a part of the normal credit management and review process. Settlement and maturity limits must conform to general credit policy requirements. Limits on the maximum residual maturity of derivative activities are governed by individual counterparty maturity constraints.

Those sanctioning CCE limits must be satisfied that they sufficiently understand the risks involved in the proposed transactions and the models used to measure the exposures arising. It is Group practice, where possible and relevant, that all appropriate documentation, such as facility letters or International Swaps and Derivatives Association ("ISDA") agreements be put in place before any limits are made available for use.

The Group uses a volatility-based risk weighting for internal purposes to determine potential future exposure values. These weightings or *add-on-factors* are derived from a rolling 3-year historical time series of price volatility data, raised to a 95th percentile one-tailed confidence interval. The Group updates these *add-on-factor* tables, which are organised by product, currency and residual maturity, on a monthly basis. Pre-settlement CCE limits for derivative transactions are established by reference to the specific transaction's *add-on-factors* equivalent.

Although Credit Support Annexes are taken into consideration when setting the internal credit risk utilisation for derivative counterparties, they are not recognised as credit risk mitigation for reducing the exposure at default on the derivative transactions in the Pillar 1 regulatory capital calculations.

Repurchase agreements

AIB Group is also active in repurchase transactions on capital market instruments. This is achieved through repo/reverse repo products and Sell Buy Back ("SBB")/Buy Sell Back ("BSB") products (together called repurchase transactions). Repurchase transactions are undertaken on both bilateral and tri-party basis.

Repo/reverse repos and SBB/BSB are products which are economically equivalent. Where appropriate netting documentation is in place, both sets of products also become legally equivalent from a credit mitigation perspective. The Group only engages in such transactions once the appropriate documentation has been executed.

Risk Management functions, independent of the front office, have responsibility for managing the margining of the Group's bilateral repo / reverse repo and SBB/BSB activities. Margining has been predominantly cash-based although the documentation in general allows for securities to be used as collateral. Tri-party margining is managed through Euroclear.

The associated credit risk is managed in the same way as other types of credit exposure. Exposures are calculated to take account of historical price volatility reflecting the maturity of both the collateral and repurchase transaction. The exposures are aggregated with all other exposures to the counterparty.

In addition to the normal credit control and risk management policies relating to counterparty credit approval, limit setting and monitoring procedures, the following credit terms received additional focus for repurchase transactions:

- a) Acceptable collateral
- b) Acceptable counterparties
- c) Appropriate nominal exposure limits by counterparty
- d) Appropriate risk weighted exposure limits by counterparty
- e) Haircut amounts (where appropriate)

As an IRB bank, AIB applies the Financial Collateral Comprehensive method for the purposes of calculating counterparty credit exposure for repurchase type transactions.

Policies for securing collateral and establishing credit reserves

It is Group practice, where possible and relevant, that ISDA Master Agreements are put in place to cover derivatives business on a counterparty specific basis. On a selective basis, the ISDA documentation has been supplemented with a Credit Support Annex to accommodate the reduction of net exposure on an agreed basis, and in line with market practice, by way of transferring a margin amount, typically cash (as opposed to securities).

AIB employs robust procedures and processes to control the residual risk that may arise when taking financial collateral, including strategy, consideration of the underlying credit and collateral management/valuation process. In addition, the Group has established standards to ensure legal certainty exists and that there is a low correlation between the credit quality of the obligor and the collateral value.

Policies with respect to one-way exposures

Where the pattern of transactions with a given counterparty is dominated by trades in one direction (e.g. customer is buyer of US dollars, but not a seller), the resulting derivative exposure may be referred to as a 'one-way' exposure. Such counterparty exposures are subject to the credit process, including grade assessment, limit setting, exposure measurement and credit review.

Change in credit rating

A downgrade in the Group's credit rating would have the effect of reducing the market value threshold for margin calls on some of the Credit Support Annexes. This would result in a potential increase in the amount of collateral the Group would have to provide against the derivatives within the Credit Support Annexes. However, due to the very small number of Credit Support Annexes with downgrade triggers, this is not deemed a significant risk for the Group.

Credit derivative hedges

The Group had minimal credit derivative activity during the year ended 31 December 2009.

Derivatives counterparty credit risk

Table 19 analyses the counterparty credit risk exposure of derivative transactions.

Table 19: Counterparty credit risk - trading & banking book

	2009					
	Positive fair value of contracts €m	Add-ons €m	Netting benefits ³⁵ €m	Gross positive fair value of contracts (incl. add-ons) €m	Financial collateral held €m	Net derivatives credit exposure €m
OTC derivatives ³⁶	6,071	1,194	(2,293)	4,972	-	4,972
Credit derivatives	-	3	-	3	-	3
Total derivatives	6,071	1,197	(2,293)	4,975	-	4,975

	2008					
	Positive fair value of contracts €m	Add-ons €m	Netting benefits ³⁵ €m	Gross positive fair value of contracts (incl. add-ons) €m	Financial collateral held €m	Net derivatives credit exposure €m
OTC derivatives ²	7,327	1,322	(1,318)	7,331	-	7,331
Credit derivatives	1	3	-	4	-	4
Total derivatives	7,328	1,325	(1,318)	7,335	-	7,335

Credit derivative transactions product distribution

Table 19a analyses the notional value of credit derivative transactions by product type, according to their origin and the purposes for which they are used.

Table 19a: Credit derivative transactions product distribution

	2009			
	Notional credit derivative transactions			
	<u>Group's own credit portfolio use</u>		<u>Intermediation activities</u>	
Credit derivative product type	Purchased €m	Sold €m	Purchased €m	Sold €m
Credit default swaps	55	602	-	-
Credit linked notes	-	213	-	-
Total	55	815	-	-

	2008			
	Notional credit derivative transactions			
	<u>Group's own credit portfolio use</u>		<u>Intermediation activities</u>	
Credit derivative product type	Purchased €m	Sold €m	Purchased €m	Sold €m
Credit default swaps	55	666	-	-
Credit linked notes	-	216	-	-
Total	55	882	-	-

³⁵The netting benefits relate to cross currency interest rate swaps only and do not reflect the effect of master netting agreements or Credit Support Annexes ("CSA") that are in place to protect the Group's position. The Group has a number of ISDA Master Agreements (netting agreements) in place which may allow it to net the termination value of derivative contracts upon the occurrence of an event of default with respect to its counterparties. The Group also has CSAs in place which provide collateral for derivative contracts.

³⁶Over the counter ("OTC") derivatives are contracts that are traded (and privately negotiated) directly between two parties, without going through an exchange or other intermediary.

11. Securitisations

Objectives in relation to securitisation activity

AIB utilises securitisation in the ordinary course of business, primarily to support the following business objectives:

- a) as an investor as part of the management of the Group's Interest Rate and Liquidity risks in Global Treasury;
- b) as an investor in and sponsor of securitisations where the Group believes that the transaction offers a superior risk adjusted return opportunity; and
- c) as an originator of securitisations, to meet customer demand to offer a full range of investment opportunities by making available opportunities to invest in AIB-managed Collateralised Debt Obligations ("CDOs") and Collateralised Bond Obligations ("CBOs").

Roles played by the Group in the securitisation process

AIB is primarily an investor in securitisations issued by other credit institutions. The Group has arranged five structured bond transactions (CDOs and CBOs) in order to meet specific customer preferences in terms of credit risk, interest rate risk, prepayment risk, maturity etc. In addition, AIB acts as a Sponsor to a small portfolio of transactions.

Extent of the Group's involvement in each securitisation

Securitisations form a small part of AIB's balance sheet, accounting for less than 3% of total Group assets.

The most significant involvement with securitisations is via Global Treasury's investment in AAA-rated prime Residential Mortgage Backed Securities ("RMBS") assets. In fulfilling its primary interest rate and liquidity management objective, Global Treasury's assessment criteria for the Residential Mortgage Backed Securities assets it purchases, includes LTV, credit enhancement, seasoning, location and quality of originator. Global Treasury also holds a significant portfolio of AAA rated US Student Loan ABS; these investments benefit from US government guarantees. It also holds a less significant portfolio of other asset classes.

The Group also has a smaller portfolio of investments in securitisations held by the Corporate Banking business unit. The portfolio consists of both cash and synthetic structures across a variety of asset classes, including Collateralised Debt Obligations ("CDOs"), Collateralised Bond Obligations ("CBOs"), Collateralised Mortgage Obligations ("CMOs") and Residential Mortgage Backed Securities ("RBMS").

The Corporate Banking business is also a sponsor of securitisation transactions. These CLO and CBO structures form a small part of their portfolio.

Finally, the Group has small equity interests in five CDO/CBO transactions which are not consolidated in the Group's Financial Accounts. The Group does not have control over these CDOs, nor does it bear the significant risks and rewards that are inherent in these assets. The deals are funded with long term financing which consists of approximately 90% rated debt notes and 10% equity. Four of these vehicles (CDOs) were created primarily to fund the European buyout market, while the fifth is invested in US High yield Bonds (CBO).

AIB does not provide liquidity lines to Asset-Backed Commercial Paper conduits or similar entities.

Accounting policies

Under IFRS, financial statements transactions and events should be accounted for and presented in accordance with their substance and economic reality and not merely their legal form. As a result, the substance of transactions with a special purpose entity ("SPE") forms the basis for their treatment in the Group's financial statements. An SPE is consolidated in the financial statements when the substance of the relationship between the Group and the SPE indicates that the SPE is controlled by the entity and meets the criteria set out in IAS 27 Consolidated and Separate Financial Statements and SIC 12 Consolidation - Special Purpose Entities.

Calculating risk weighted exposure amounts

As an IRB bank, AIB Group primarily uses the Ratings Based Method to calculate the risk-weighted exposure amount for securitisations. Under this approach, where investments are rated, risk weights are assigned to securitisation tranches on the basis of the credit ratings applied to these by approved External Credit Assessment Institutions (“ECAIs”). Where there is no credit rating, but other criteria are met to apply a risk band other than unrated, the Supervisory Formula Method is applied to the exposures to establish the relevant risk weight.

External Credit Assessment Institutions

AIB uses the following ECAIs for securitisation exposures:

- Moody's Investors Service
- Standard & Poor's Ratings Services
- Fitch Ratings
- Dominion Bond Rating Service

The process used to assign credit assessments to risk weights follows the mapping guidelines issued by the Committee of European Banking Supervisors (“CEBS”) and adopted by the Financial Regulator.

There is no outstanding amount of securitised revolving exposures. In relation to the following sets of tables:

- exposure type* refers to the assets that are contained in the pool on which the securitisation paper is issued.
- traditional* securitisation means a securitisation involving the economic transfer of the exposures being securitised to a securitisation special purpose entity which issues securities. This is accomplished by the transfer of ownership of the securitised exposures from the originator credit institution or through sub participation. The securities issued do not represent payment obligations of the originator credit institution.
- synthetic* securitisation means a securitisation where the tranching is achieved by the use of credit derivatives or guarantees, and the pool of exposures is not removed from the balance sheet of the originator credit institution.

Table 20: Securitisation losses and assets impaired or past due

Retained and purchased				2009		
Exposure type	Outstanding amount of exposures subject to securitisation framework			Of which:		
	Traditional transactions €m	Synthetic transactions €m	Total €m	Impaired €m	Past due €m	Recognised losses €m
Residential mortgages	4,043	62	4,105	69	-	(38)
Commercial mortgages	331	179	510	-	-	-
Leasing	18	-	18	-	-	-
Loans to corporates or SMEs	428	424	852	-	-	-
Consumer loans	813	-	813	-	-	-
Total	5,633	665	6,298	69	-	(38)
Total 2008	6,999	750	7,649	22	-	(32)

Table 21 details the Group's involvement in securitisations by risk weight bands, split between the equity interests retained in the CDO/CBO transactions where AIB Group has acted as originator and the investments made by Global Treasury and Corporate Banking in asset backed securities as either sponsor or investor, the most significant of which are in AAA-rated prime RMBS.

Table 21: Securitisation positions - risk weight bands

Risk weight band	2009			Total €m
	Securitisation positions – total exposures			
	Retained	Purchased		
	Originator	Sponsor	Investor	
	€m	€m	€m	
7 – 10%	-	-	4,933	4,933
11 – 19%	-	51	76	127
20 – 49%	-	65	89	154
50 – 75%	-	104	111	215
75 – 99%	-	-	-	-
100%	-	30	53	83
250%	-	-	50	50
350%	-	-	-	-
425%	-	-	44	44
650%	-	5	55	60
651% - 1249%	-	219	-	219
1250% or deducted	28	22	391	441
Total	28	496	5,802	6,326

Risk weight band	2008			Total €m
	Securitisation positions – total exposures			
	Retained	Purchased		
	Originator	Sponsor	Investor	
	€m	€m	€m	
7 – 10%	-	11	6,133	6,144
11 – 19%	-	119	149	268
20 – 49%	-	149	175	324
50 – 75%	-	110	232	342
75 – 99%	-	-	-	-
100%	-	-	194	194
250%	-	-	10	10
350%	-	-	-	-
425%	-	150	36	186
650%	-	-	2	2
651% - 1249%	-	-	-	-
1250% or deducted	30	-	179	209
Total	30	539	7,110	7,679

The deduction in relation to retained securitisation positions relates to equity interests in the five CDO/CBOs. Certain tranches of the purchased non-originated investments in securitisations were downgraded (below BB-) during the year, accordingly these are deducted from capital.

12. Equity exposures in the banking book

AIB calculates its capital requirements for equity exposures in the banking book using the Standardised Approach. The Group's equity activity can be divided into the following five sub-categories:

- a) Quoted investments: a limited number of straight equity positions that are quoted on recognised stock exchanges;
- b) Unquoted investments: typically comprising exposure to equities or the equity tranche in a structured transaction or SPE;
- c) Managed funds: typically comprising exposure to the equity component of a managed investment fund;
- d) Retained equity tranches in CBO/CDO SPEs, established and managed by the Group on an ongoing basis; and
- e) Investments in associate undertakings which are held by the Group for strategic purposes.

While individual transactions will vary in structure, the Group's profit objectives are typically realised through a combination of fee income (e.g. structuring or management fees), dividend income and capital gains on realisation.

The principal accounting policies applied by the Group to equity investments is informed by International Accounting Standards IFRS 7, IAS 28 and IAS 39 which set out the rules for classification, balance sheet recognition, methods of valuation (i.e. fair value), income and impairment recognition and disclosures. Further information in relation to the Group accounting policies for financial assets, which include equities, can be found in the Group's 2009 Annual Financial Report. Investments in associated undertakings are initially recorded at cost and increased (or decreased) each year by the Group's share of the post acquisition net income (or loss), and other movements reflected directly in the equity of the associated undertaking. Other banking book equities are carried on the balance sheet at fair value.

Goodwill arising on the acquisition of an associated undertaking is included in the carrying amount of the investment (net of any accumulated impairment loss). For regulatory purposes, goodwill in associates is deducted directly from capital.

The cumulative realised gains from sales and liquidations in the banking book of equity investments amount to €8 million for the year ended 31 December 2009 (2008: €75 million). The total unrealised gains as at 31 December 2009, gross of tax, in the banking book of equity investments amounts to €151 million (2008: €139 million). An unrealised loss, after tax, of €9 million (2008: €10 million) is included in tier 1 capital whilst an unrealised gain, after tax, of €131 million (2008: €131 million) is included in tier 2 capital for regulatory capital calculations. There were no latent revaluation gains or losses. Further details in relation to this are contained in Appendix 1: Own funds.

Table 22: Banking book equity values

			2009
			Carrying value
	Type	Nature	€m
Exchange traded exposures	Quoted	A limited number of straight equity positions that are quoted on recognised stock exchanges.	53
Other exposures	Unquoted	Exposure to equities or the equity tranche in a structural transaction or SPE	150
	Funds	Exposure to the equity component of a managed investment fund.	96
	CDOs/CBOs	Equity interest in Collateralised Debt Obligation SPEs created and managed by Group on an ongoing basis.	28
Investments in associate undertakings			1,641
Less goodwill ³⁷			(684)
			957
Total			1,284
Of which are risk weighted			922
Of which deducted from capital			362
Total			1,284
			2008
			Carrying value
	Type	Nature	€m
Exchange traded exposures	Quoted	A limited number of straight equity positions that are quoted on recognised stock exchanges.	34
Other exposures	Unquoted	Exposure to equities or the equity tranche in a structural transaction or SPE	130
	Funds	Exposure to the equity component of a managed investment fund.	93
	CDOs/CBOs	Equity interest in Collateralised Debt Obligation SPEs created and managed by Group on an ongoing basis.	30
Investments in associate undertakings			1,968
Less goodwill ¹			(1,018)
			950
Total			1,237
Of which are risk weighted			959
Of which deducted from capital			278
Total			1,237

Table 23: Risk weighted asset equivalents of equity exposures

		2009	
		Exposure	Risk weighted asset
		€m	€m
Equity investments subject to a 100% risk weight		824	824
Equity investments subject to a 150% risk weight		98	147
Total		922	971
Total 2008		959	616

³⁷Deducted from tier 1 capital

13. Non-trading interest rate risk

As already described in section 3.3, non-trading interest rate risk is the Group's sensitivity to earnings volatility in its non-trading activity arising from movements in interest rates. The nature of interest rate risk arising in the banking book and the key assumptions used in measuring interest rate risk are also explained in section 3.3.

The table below sets out the impact on the Group's own funds for a 1 per cent upward and 1 per cent downward interest rate shock, broken down by the Group's main currencies.

Table 24: Non-trading interest rate risk

2009				
Currency	Interest rate risk variation			
	Absolute € m		% of Own funds	
	+1%	-1%	+1%	-1%
EUR	168	(178)	1.4%	(1.4%)
GBP	28	(24)	0.2%	(0.2%)
PLN	(15)	15	(0.1%)	0.1%
USD	(23)	23	(0.2%)	0.2%
Other	(5)	4	-	-
Total	153	(160)	1.3%	(1.2%)
2008				
Currency	Interest rate risk variation			
	Absolute € m		% of Own funds	
	+1%	-1%	+1%	-1%
EUR	177	(170)	1.3%	(1.2%)
GBP	(130)	147	(0.9%)	1.0%
PLN	(17)	15	(0.1%)	0.1%
USD	(17)	21	(0.1%)	0.2%
Other	(17)	17	(0.1%)	0.1%
Total	(4)	30	0.1%	0.2%

Appendix 1: Own funds

Summary information on the main components of own funds items, and their terms and conditions as applicable, is set out below. Further information on the terms and conditions of the government preference shares and warrants is available in Appendix 3: Other relevant disclosures.

TIER 1

Core tier 1

Paid up share capital

Ordinary and preference share capital comprising shares of the parent company represent funds raised by issuing shares in return for cash or other consideration. Preference share capital arises from the issue to the Irish Government, through the National Pension Reserve Fund Commission, of non-cumulative redeemable preference shares in May 2009.

Eligible reserves

Included in the eligible reserves are the following capital components:

Share premium (ordinary and preference)

When shares are issued at a premium whether for cash or otherwise, the excess of the amount received over the par value of the shares is transferred to share premium. Preference share premium arises from the issue to the Irish Government, through the National Pension Reserve Fund Commission, of non-cumulative redeemable preference shares in May 2009.

Revenue reserves

Revenue reserves represent retained earnings of the parent company, subsidiaries and its associated undertakings. Revenue reserves are shown gross of the cumulative deficit within the defined benefit pension schemes.

Available for sale equity securities

Unrealised losses on available for sale equity securities are deducted from tier 1 eligible reserves.

Foreign currency translation reserve

The foreign currency translation reserve represents the cumulative gains and losses on the retranslation of the Group's net investment in foreign operations, at the rate of exchange at the reporting date.

Treasury shares

Where the parent or other members of the Group purchase the share capital of Allied Irish Banks, p.l.c., the consideration paid is deducted from total shareholders' equity as treasury shares. Where such shares are subsequently sold or re-issued, any consideration received is included in shareholders' equity.

Share based payment reserve

The share based payment expense charged to the income statement is credited to the share based payment reserve over the vesting period of the shares and options. Upon grant of shares or exercise of options and consequent re-issue of treasury shares, the amount in respect of the award credited to the share based payment reserve is transferred to treasury shares.

Capital reserves

Capital reserves represent transfers from retained earnings in accordance with relevant legislation.

Equity non-controlling interests in subsidiaries

Equity non-controlling interests in subsidiaries relate to interests of outside shareholders in consolidated subsidiaries (i.e. BZWBK)

Non-core tier 1

Non-equity non-controlling interests in subsidiaries

The € 1 billion Fixed Rate/Floating Rate Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities ('Preferred Securities') were issued through a Limited Partnership ("LPI") at par and have the benefit of a subordinated guarantee of Allied Irish Banks, p.l.c. ("AIB"). The Preferred Securities have no fixed final redemption date and the holders have no rights to call for the redemption of the Preferred Securities. At 31 December 2009, € 189 million remained outstanding following the debt exchange in June 2009 of € 801 million of the Preferred Securities.

The Preferred Securities are redeemable in whole but not in part at the option of the general partner and with the agreement of the Financial Regulator (i) upon the occurrence of certain events, or (ii) on or after 17 December 2014, subject to the provisions of the Limited Partnership Act, 1907.

Distributions on the Preferred Securities are non-cumulative. The distributions are payable at a rate of 4.781% per annum up to 17 December 2014 and thereafter at the rate of 1.10% per annum above 3 month EURIBOR, reset quarterly. The discretion of the Board of Directors of AIB to resolve that a distribution should not be paid is unfettered. The coupon on the Preferred Securities which was due to be paid on 17 December 2009 was not paid.

In the event of the dissolution of the Limited Partnership, holders of Preferred Securities will be entitled to receive a liquidation preference in an amount equal to the distributions that those holders would have received in a dissolution of AIB at that time, if they had held, instead of the Preferred Securities, non-cumulative preference shares issued directly by AIB, having the same liquidation preference as the Preferred Securities, and ranking junior to all liabilities of AIB including subordinated liabilities.

Non-cumulative perpetual preferred securities

In June 2006 Stg£ 350 million and €500 million Fixed Rate/Floating Rate Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities ('Preferred Securities') were issued through Limited Partnerships. The Preferred Securities were issued at par, have the benefit of a subordinated guarantee of Allied Irish Banks, p.l.c. ("AIB"), have no fixed final redemption date and the holders have no rights to call for the redemption of the Preferred Securities. The substitution of the Preferred Securities with fully paid non-cumulative preference shares issued by the Guarantor is subject, in particular cases, to certain events and conditions that are beyond the control of both the Guarantor and the holders of the Preferred Securities.

The distributions on the Preferred Securities are non-cumulative. The Board of Directors has the discretion not to pay a distribution on the Preferred Securities, unless the Preferred Securities no longer qualify as regulatory capital resources of AIB, and AIB is in compliance with its capital adequacy requirements.

In the event of the dissolution of the Limited Partnerships, holders of Preferred Securities will be entitled to receive a liquidation preference in an amount equal to the distributions that those holders would have received in a dissolution of AIB at that time, if they had held, instead of the Preferred Securities, non-cumulative preference shares issued directly by AIB, having the same liquidation preference as the Preferred Securities, and ranking junior to all liabilities of AIB including subordinated liabilities.

The distributions on the Stg£ 350 million Preferred Securities ("LP3") are payable at a rate of 6.271% semi-annually until 14 June 2016 and thereafter at a rate of 1.23% per annum above 3 month LIBOR, payable quarterly. The coupon on LP3 which was due to be paid on 14 December 2009 was not paid. The LP3 Preferred Securities are redeemable in whole but not in part at the option of the general partner and with the agreement of the Financial Regulator (i) upon the occurrence of certain events or (ii) on or after 14 June 2016. At 31 December 2009, Stg£ 36.6 million remained outstanding following the redemption in June 2009 of Stg£ 312.1 million of the preferred securities.

The distributions on the € 500 million Preferred Securities ("LP2") are payable at a rate of 5.142% per annum until 16 June 2016 and thereafter at a rate of 1.98% per annum above 3 month LIBOR, payable quarterly. The LP2 preferred securities are redeemable in whole but not in part at the option of the general partner and with the agreement of the Financial Regulator (i) upon the occurrence of certain events or (ii) on or after 16 June 2016. At 31 December 2009, € 95 million remained outstanding following the redemption in June 2009 of € 403 million of the preferred securities.

Reserve capital instruments

In February 2001, Reserve Capital Instruments (“RCIs”) of £ 500 million were issued by Allied Irish Banks, p.l.c. at an issue price of 100.069%. The RCIs are perpetual securities and have no maturity date. The RCIs are redeemable, in whole but not in part, at the option of the Bank and with the agreement of the Financial Regulator (i) upon the occurrence of certain events, or (ii) on or after 28 February 2011, an authorised officer having reported to the Trustees within the previous six months that a solvency condition is met.

The RCIs bear interest at a rate of 7.50% per annum from (and including) 5 February 2001 to (but excluding) 28 February 2011 and thereafter at 3.33% per annum above three month EURIBOR, reset quarterly.

The rights and claims of the RCI holders and the coupon holders are subordinated to the claims of the senior creditors and the senior subordinated creditors of the issuer. In the event of a winding up of the issuer, the RCI holders will rank *pari passu* with the holders of the classes of preference shares (if any) from time to time issued by the issuer and in priority to all other shareholders. The coupon on the RCI which was due to be paid on 28 February 2010 was not paid.

At 31 December 2009, € 239 million remained outstanding following the redemption in June 2009 of € 258 million of the RCI.

TIER 2

Upper level tier 2

Eligible reserves

Fixed asset revaluation reserves

Revaluation reserves represent the unrealised surplus, net of tax, which arose on revaluation of properties prior to the implementation of IFRS at 1 January 2004.

Available for sale equity securities

Unrealised gains on available for sale equity securities are included in tier 2 eligible reserves.

Incurred but not reported (“IBNR”) provisions

For IFRS purposes impairment provisions on financial assets are required to be recognised in respect of losses that have been incurred but not reported (“IBNR”). An IBNR provision represents an interim step pending the identification of impairment losses on an individual asset in a group of financial assets. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group. This IBNR provision on the standardised portfolio is included as tier 2 capital.

Subordinated perpetual loan capital

This consists of the following capital issues:

- a) US\$ 100 million Floating Rate Primary Capital Perpetual Notes;
- b) € 200 million Fixed Rate Perpetual Subordinated Notes; and
- c) Stg£ 400 million Perpetual Callable Step-Up Subordinated Notes.

The US\$ 100 million Floating Rate Primary Capital Perpetual Notes, with interest payable quarterly, have no final maturity but may be redeemed at par at the option of the Bank, on each coupon payment date, with the prior approval of the Central Bank and Financial Services Authority of Ireland (‘the Financial Regulator’).

The € 200 million Fixed Rate Perpetual Subordinated Notes, with interest payable annually at a rate of 6.20% up to 3 August 2009, and with interest payable quarterly at a rate of 2.25% per annum above 3 month EURIBOR thereafter, have no final maturity but may be redeemed at the option of the Bank, with the prior approval of the Financial Regulator, on each coupon payment date on or after 3 August 2009. At 31 December 2009, € 53.8 million remained outstanding following the redemption in June 2009 of € 146.2 million of the subordinated notes.

The Stg£ 400 million Perpetual Callable Step-Up Subordinated Notes with interest payable annually up to 1 September 2015 and with interest payable quarterly thereafter, have no final maturity but may be redeemed at the option of the Bank, with the prior approval of the Financial Regulator, on 1 September 2015 and every interest payment date thereafter. At 31 December 2009, Stg£ 58.6 million

remained outstanding following the redemption in June 2009 of Stg£ 341.4 million of the subordinated notes.

Lower level tier 2

Subordinated term loan capital

This consists of the following capital issued by Allied Irish Banks, p.l.c.:

- a) US\$ 400 million Floating Rate Notes³⁸;
- b) € 400 million Floating Rate Notes¹;
- c) € 500 million Callable Subordinated Step-up Floating Rate Notes¹;
- d) € 869 million Fixed Rate Notes;
- e) Stg£ 368 million Fixed Rate Notes;
- f) Stg£ 700 million Callable Dated Subordinated Fixed/ Floating Rate Notes¹;
- g) Stg£ 500 million Subordinated Callable Fixed/Floating Rate Notes¹;
- h) Stg£ 350 million Fixed Rate Notes¹; and
- i) JPY 20 billion Callable Subordinated Step-up Fixed/Floating Rate Notes.

The dated loan capital in this section issued under the European Medium Term Note programme (“EMTN”) is subordinated in right of payment to the ordinary creditors, including depositors, of the Group.

The US\$ 400 million Floating Rate Notes, with interest payable quarterly, may be redeemed, in whole but not in part, on any interest payment date falling on or after July 2010.

The € 400 million Floating Rate Notes, with interest payable quarterly, may be redeemed, in whole but not in part, on any interest payment date falling on or after March 2010.

The € 500 million Callable Subordinated Step-Up Floating Rate Notes with interest payable quarterly may be redeemed in whole but not in part on any interest payment date falling on or after 24 October 2012.

The € 869 million Subordinated Notes with interest paid annually in arrears, at a rate of 12.5% per annum until maturity in June 2019.

The Stg£ 368 million Subordinated Notes with interest paid annually in arrears, at a rate of 12.5% per annum until maturity in June 2019.

The Stg£ 700 million Callable Dated Subordinated Fixed/Floating Rate Notes with interest paid semi-annually in arrears, at a rate of 7.875% per annum until June 2018. The notes may be redeemed, in whole but not in part, on any quarterly interest payment date falling on or after June 2018 during which period the floating rate will be 3.5% above 3 month sterling Libor.

The Stg£ 500 million Subordinated Callable Fixed/Floating Rate Notes, with interest payable annually, up to 10 March 2020 at a rate of 5.25% and with interest payable quarterly thereafter at a rate of 1.28% above 3 month sterling Libor may be redeemed, in whole but not in part on any interest payment date falling on or after 10 March 2020.

The Stg£ 350 million Callable Fixed/Floating Rate Notes, with interest payable annually in arrears on 26 November in each year, at a rate of 5.625% up to November 2025. The notes may be redeemed, in whole but not in part, on the 26 November 2025 and on each interest payment date thereafter during which period the floating rate will be 1.45% above 3 month sterling Libor.

The Japanese Yen (“JPY”) 20 billion Callable Subordinated Step-up Fixed/Floating Rate Notes, with interest payable semi annually at a rate of 2.75% up to March 2037 and with interest payable semi annually thereafter at a rate of 0.78% above JPY Libor, are redeemable in whole but not in part on any interest payment date falling on or after 8 March 2037.

In all cases, redemption prior to maturity is subject to the necessary prior approval of the Financial Regulator. There is no exchange exposure as the proceeds of these notes are retained in their respective currencies.

³⁸On 29 March 2010, Allied Irish Banks, p.l.c. completed an exchange of existing lower tier 2 securities for new higher yielding lower tier 2 securities at a discount to their nominal value or issue price, but at a premium to their trading range. The remaining principal amounts on the equity instruments are noted as appropriate above. The new instruments issued in exchange are as follows: Stg£ 1,096,645,000 11.5 per cent. Subordinated Notes due 2022, € 419,070,000 10.75 per cent. Subordinated Notes due 2017, US\$ 177,096,000 10.75 per cent. Subordinated Notes due 2017.

Supervisory deductions from core tier 1

Goodwill and intangible assets

Goodwill and intangible assets are deducted from core tier 1 capital.

Pension filter

Cash contributions to pension schemes are agreed between the Trustees and the employer on a triennial basis and comprise an amount to cover the expected current service cost and an amount to eliminate any pension deficit arising at the triennial valuation. Excess contributions to eliminate a pension deficit are deducted from capital based on the rules applied by the local regulator.

Supervisory deductions from tier 1 and tier 2 capital

Holdings in other credit and financial institutions

Holdings in other credit and financial institutions' equity capital or other qualifying capital instruments are required to be deducted if the holding exceeds 10% of the regulatory capital of the institution. The deduction amounts to the excess of the investment in these instruments over 10% of the regulatory capital of the institution. The required deduction is made 50% from tier 1 and 50% from tier 2.

Expected loss adjustment

The expected loss on the IRB portfolios is compared to the IFRS provisions on the IRB Portfolios. The excess of the expected loss over the IFRS provisions is deducted 50% from tier 1 and 50% from tier 2.

Securitisation positions

Certain securitisation exposures, where the Group is either an originator or an investor, are treated as deductions from capital and thus excluded from the risk weighted asset calculation. The required deduction is made 50% from tier 1 and 50% from tier 2 capital.

Supervisory deductions from gross capital

Holdings in insurance undertakings

Holdings in insurance undertakings are required to be deducted if the holding exceeds 10% of the capital of the institution. The deduction amounts to the excess of the investment in the institution over 10% of the capital of the institution. The required deduction is made from total capital.

Appendix 2: Subsidiary disclosures

Article 72 of the CRD, requires the Group to disclose various information on the calculation of capital ratios and own funds of its significant subsidiaries. The Group has provided this information on the following pages for the significant subsidiaries:

- a) Allied Irish Banks, p.l.c.;
- b) AIB Mortgage Bank;
- c) AIB Group (UK) p.l.c.; and
- d) Bank Zachodni WBK S.A.

The Basel II capital ratios are based on Pillar 1 ('minimum capital requirements') under the CRD. Under Pillar 2 ('supervisory review') banks may estimate their own capital requirements through an Internal Capital Adequacy Assessment Process ("ICAAP") which is subject to supervisory review and evaluation. The ICAAP evaluation is currently in progress.

Figures reported for AIB Group (UK) p.l.c. and Bank Zachodni WBK S.A. represent the position as reported to their local regulators. The closing exchange rate on 31 December 2009 used to translate Polish zloty ("PLN") and sterling ("Stg£") to euro are € 1 = PLN 4.1045 and € 1 = Stg£ 0.8881 respectively, consistent with the 2009 Annual Financial Report

Table 25: Capital base of significant subsidiaries

	2009			
	Allied Irish Banks, p.l.c. €m	AIB Mortgage Bank ³⁹ €m	AIB Group (UK) p.l.c. €m	Bank Zachodni WBK S.A. €m
Tier 1				
Paid up share capital	329	450	1,678	178
Eligible reserves	8,497	120	22	1,097
Equity non-controlling interests in subsidiaries	-	-	-	26
Supervisory deductions from core tier 1 capital	(428)	-	(1)	(44)
Core tier 1 capital	8,398	570	1,699	1,257
Non-equity non-controlling interests in subsidiaries	189	-	-	-
Non-cumulative perpetual preferred securities	136	-	-	-
Reserve capital instruments	239	-	-	-
Supervisory deductions from tier 1 capital	(1,959)	(39)	(21)	(8)
Total tier 1 capital	7,003	531	1,678	1,249
Tier 2				
Fixed asset revaluation reserve	28	-	4	76
IBNR provisions (Standardised portfolio)	259	2	160	-
Subordinated perpetual loan capital	189	200	1,424	-
Subordinated term loan capital	4,261	100	-	-
Supervisory deductions from tier 2 capital	(1,959)	(39)	(21)	(8)
Total tier 2 capital	2,778	263	1,567	68
Gross capital	9,781	794	3,245	1,317
Supervisory deductions	-	-	-	-
Total capital	9,781	794	3,245	1,317
Risk weighted assets				
Credit risk	84,278	5,010	19,398	8,633
Market risk	1,616	-	-	182
Operational risk	4,915	181	1,123	1,333
Capital floor	-	4,013	-	-
Total risk weighted assets	90,809	9,204	20,521	10,148
Capital ratios				
Core tier 1	9.2%	6.2%	8.3%	12.4%
Tier 1	7.7%	5.8%	8.2%	12.3%
Total	10.8%	8.6%	15.8%	13.0%

³⁹Following the application of the CRD requirements, the risk weightings of the assets within AIB Mortgage Bank reduced considerably. As a result AIB Mortgage Bank was the only licensed bank within AIB Group that was impacted by the capital floor requirements as discussed in section 4.

Table 25: Capital base of significant subsidiaries

	2008			
	Allied Irish Banks, p.l.c. €m	AIB Mortgage Bank ⁴⁰ €m	AIB Group (UK) p.l.c. €m	Bank Zachodni WBK S.A. €m
Tier 1				
Paid up share capital	294	450	462	176
Eligible reserves	6,769	88	1,062	888
Equity non-controlling interests in subsidiaries	-	-	-	58
Supervisory deductions from core tier 1 capital	(379)	-	(1)	(42)
Core tier 1 capital	6,684	538	1,523	1,080
Non-equity non-controlling interests in subsidiaries	990	-	-	-
Non-cumulative perpetual preferred securities	867	-	-	-
Reserve capital instruments	497	-	-	-
Supervisory deductions from tier 1 capital	(1,179)	(20)	(21)	(5)
Total tier 1 capital	867	518	1,502	1,075
Tier 2				
Fixed asset revaluation reserve	27	-	4	73
IBNR provisions (Standardised portfolio)	138	-	149	-
Subordinated perpetual loan capital	692	200	1,050	-
Subordinated term loan capital	2,970	100	-	-
Supervisory deductions from tier 2 capital	(1,179)	(20)	(21)	(5)
Total tier 2 capital	2,648	280	1,182	68
Gross capital	10,507	798	2,684	1,143
Supervisory deductions	-	-	-	-
Total capital	10,507	798	2,684	1,143
Risk weighted assets				
Credit risk	94,477	5,920	19,659	9,385
Market risk	1,288	-	-	63
Operational risk	3,524	186	957	1,185
Capital floor	-	3,244	-	-
Total risk weighted assets	99,289	9,350	20,615	10,632
Capital ratios				
Core tier 1	6.7%	5.8%	7.4%	10.1%
Tier 1	7.9%	5.5%	7.3%	10.1%
Total	10.6%	8.5%	13.0%	10.1%

⁴⁰Following the application of the CRD requirements, the risk weightings of the assets within AIB Mortgage Bank reduced considerably. As a result AIB Mortgage Bank was the only licensed bank within AIB Group that was impacted by the capital floor requirements as discussed in section 4.

Table 26: Minimum capital requirement of significant subsidiaries

	2009			
	Allied Irish Banks, p.l.c. €m	AIB Mortgage Bank ⁴¹ €m	AIB Group (UK) p.l.c. €m	Bank Zachodni WBK S.A €m
Standardised credit risk exposure class				
Central governments and central banks	-	-	-	1
Administrative bodies and non-commercial undertakings	38	-	-	-
Institutions ⁴²	290	-	1	5
Corporates	673	-	1,208	130
Retail	372	-	75	122
Secured on real estate property	497	12	97	377
Past due items ⁴³	132	3	151	30
Items belonging to regulatory high risk categories	21	-	-	-
Collective investment undertakings	-	-	-	1
Other items	124	-	20	30
Total for Standardised Approach	2,147	15	1,552	696
Foundation IRB exposure class				
Central governments and central banks	1	-	-	-
Institutions ²	178	-	-	-
Corporates	4,024	122	-	-
Retail	142	264	-	-
Securitisation positions	247	-	-	-
Non-credit obligation assets	1	-	-	-
Total for Foundation IRB Approach	4,593	386	-	-
Total for credit risk	6,740	401	1,552	696
Total for market risk	124	-	-	15
Total for operational risk	393	14	80	107
Total for capital floor	-	252	-	-
Total minimum capital requirement	7,257	667	1,632	818

⁴¹Following the application of the CRD requirements, the risk weightings of the assets within AIB Mortgage Bank reduced considerably. As a result AIB Mortgage Bank was the only licensed bank within AIB Group that was impacted by the capital floor requirements as discussed in section 4.

⁴²Institution exposure class predominantly relates to banks.

⁴³The Basel Standardised asset class past due items only includes exposures that are (a) standardised, (b) greater than 90 days past due or defaulted and (c) impaired.

Table 26: Minimum capital requirement of significant subsidiaries

	2008			
	Allied Irish Banks, p.l.c. €m	AIB Mortgage Bank ⁴⁴ €m	AIB Group (UK) p.l.c. €m	Bank Zachodni WBK S.A €m
Standardised credit risk exposure class				
Central governments and central banks	-	-	1	-
Administrative bodies and non-commercial undertakings	3	-	-	-
Institutions ⁴⁵	235	-	1	17
Corporates	1,354	10	1,298	475
Retail	417	-	70	131
Secured on real estate property	17	-	93	83
Past due items ⁴⁶	40	-	86	12
Items belonging to regulatory high risk categories	11	-	-	3
Collective investment undertakings	-	-	-	1
Other items	104	-	22	29
Total for Standardised Approach	2,181	10	1,571	751
Foundation IRB exposure class				
Central governments and central banks	1	-	-	-
Institutions ²	239	-	-	-
Corporates	4,875	295	-	-
Retail	107	169	-	-
Securitisation positions	154	-	-	-
Non-credit obligation assets	-	-	-	-
Total for Foundation IRB Approach	5,376	464	-	-
Total for credit risk	7,557	474	1,571	751
Total for market risk	103	-	-	5
Total for operational risk	282	15	76	95
Total for capital floor	-	259	-	-
Total minimum capital requirement	7,942	748	1,647	851

⁴⁴Following the application of the CRD requirements, the risk weightings of the assets within AIB Mortgage Bank reduced considerably. As a result AIB Mortgage Bank was the only licensed bank within AIB Group that was impacted by the capital floor requirements as discussed in section 4.

⁴⁵Institution exposure class predominantly relates to banks.

⁴⁶The Basel standardised asset class past due items only includes exposures that are (a) standardised, (b) greater than 90 days past due or defaulted and (c) impaired.

Appendix 3: Other relevant disclosures

Accounting policies

The full description of the Group's accounting policies is described on pages 125 to 145 in the 2009 Annual Financial Report. The following is relevant to this report.

Insurance contracts

In the preparation of the 2009 Annual Financial Report, the Group has changed its method of accounting for insurance contracts from European Embedded Value ("EEV") to Market Consistent Embedded Value ("MCEV") principles. This follows the publication by the European Insurance CFO Forum of the MCEV principles, which will replace the EEV principles as the CFO Forum endorsed method of embedded value reporting from 1 January 2011.

These principles provide a framework intended to improve comparability and transparency in embedded value reporting across Europe. The adoption of MCEV principles is expected to deliver a shareholder perspective on value, being the present value of cash flows available to shareholders, adjusted for the risks of those cash flows; and a market consistent approach to financial risk.

This change in accounting policy has been accounted for retrospectively and the comparative financial statements have been restated. The change had the impact of increasing the investment in associates, total assets, retained earnings and total liabilities by € 26 million at 31 December 2007 and by € 31 million at 31 December 2008.

Further information is available in the 2009 Annual Financial Report, which is available on the Group's website (www.aibgroup.com).

Notes to the 2009 Financial Statements

The complete set of notes to the accounts is described on pages 156 to 285 in the 2009 Annual Financial Report. The following are relevant to this report.

Redemption of capital instruments

As part of the Group's initiative to raise additional core tier 1 capital, the Group completed the exchange of non-core tier 1 and upper tier 2 capital instruments for a lower tier 2 issue on 25 June 2009. This involved the redemption of the securities at a discount to their nominal value or issue price, but at a premium to their trading range. The consideration for the redemption was the issue of euro and sterling subordinated capital instruments. This exchange of debt is accounted for under IAS 39 and met the requirements to be treated as an extinguishment of the original instruments. It resulted in a total gain of € 1,161 million with € 623 million being recorded in the income statement and a gain of € 538 million being recorded directly in equity. The gain recorded in the income statement relates to those instruments which were held as liabilities on the statement of financial position as 'Subordinated liabilities and other capital instruments' whilst the gain recorded directly in equity refers to instruments recorded under 'Shareholders' equity'.

Further information is available in the 2009 Annual Financial Report, which is available on the Group's website (www.aibgroup.com).

Relationship with the Irish Government

1. National Assets Management Agency ("NAMA").

On 7 April 2009, the Minister for Finance announced the Government's intention to establish a national asset management agency. On 22 November 2009, the NAMA Act was enacted providing for the establishment of the National Asset Management Agency ("NAMA"). The participation of AIB in the NAMA programme was approved by shareholders at an Extraordinary General Meeting held on 23 December 2009. The purposes of the NAMA Act include the restoration of stability to the banking system and the facilitation of restructuring of credit institutions of systemic importance to the Irish economy. Allied Irish Banks, p.l.c. and each of its subsidiaries was designated a participating institution under the Act on 12 February 2010. BZW BK and its subsidiaries was excluded from the designation.

Based on Government statements, eligible asset regulations and its ongoing interaction with NAMA, the Group estimates that NAMA may acquire from AIB land and development loans and certain associated loans with a value of up to approximately € 23.2 billion on a gross loan basis (i.e. before taking account of € 4.2 billion of loan loss provisions) together with related derivatives and

accrued interest of € 0.2 billion. The consideration for the NAMA assets acquired from AIB will comprise the issue to AIB of NAMA bonds and subordinated NAMA bonds, the nominal value of which will be equal to the agreed purchase price of the NAMA Assets.

2. National Pension Reserve Fund Commission (“NPRFC”)

On 13 May 2009, in implementing the Government’s recapitalisation of AIB, the Group issued: (i) € 3.5 billion of core tier 1 securities in the form of non-cumulative redeemable preference shares (the ‘2009 Preference Shares’) and (ii) 294,251,819 warrants over ordinary shares (the ‘2009 Warrants’), to the NPRFC for an aggregate subscription price of € 3.5 billion. The NPRFC, the Government’s national pensions reserve fund, is controlled by the NPRFC and managed by the National Treasury Management Agency (“NTMA”).

2009 Preference shares

The shares carry a fixed non cumulative dividend at a rate of 8% per annum, payable annually in arrears at the discretion of AIB. If a cash dividend is not paid, AIB must issue bonus ordinary shares to the holders of the 2009 Preference Shares by capitalising its reserves. The issue of bonus shares can be deferred by AIB, but the holders of 2009 Preference Shares will acquire voting rights at general meetings of AIB equivalent to the voting rights that would have attached to the bonus shares if they had been issued. The dividend may not be deferred beyond the date on which AIB (a) pays a cash dividend on the 2009 Preference Shares, the Perpetual Preferred Securities issued by LPI, or on the Ordinary Shares; or (b) redeems or purchases any of the 2009 Preference Shares, the Perpetual Preferred Securities issued by LPI, or Ordinary Shares.

The 2009 Preference Shares may be purchased or redeemed at the option of AIB, in whole or in part, from distributable profits and/or the proceeds of an issue of shares constituting core tier 1 capital, for the first five years after the date of issue for the subscription price of € 1.00 per share and thereafter at redemption or purchase price of 125 per cent of the subscription price, subject at all times to the consent of the Financial Regulator.

The NPRFC has the right to appoint directly 25 per cent. of the directors of AIB and has voting rights equal to 25 per cent. of all votes capable of being cast by shareholders on a poll at a general meeting of the Group on shareholder resolutions relating to: (i) the appointment, reappointment or removal of Directors; and (ii) a change of control of AIB or a sale of all or substantially all of its business. In relation to item (i) above, the 25 per cent. voting rights entitlement is inclusive of the voting rights of all Government entities in respect of any ordinary shares they may hold.

To the extent that the NPRFC holds ordinary shares, it is not restricted from exercising its voting rights in respect of such ordinary shares at a general meeting of the Group.

The 2009 Preference Shares are freely transferable in minimum lots of 50,000 shares. However, the voting rights attaching to the 2009 Preference Shares, the right to appoint directors to the board of AIB (both as described above) and the veto over certain share capital-related resolutions (as described below) are not transferable, as those rights are exercisable only by a Government Preference Shareholder.

The 2009 Warrants

In conjunction with the issue of the 2009 Preference Shares, the Group issued 294,251,819 Warrants to the NPRFC. Each warrant entitles the holder to subscribe for one ordinary share of Allied Irish Banks, p.l.c.. The Warrants are exercisable in the period between the fifth and tenth anniversary of the date on which the Preference Shares were issued (or earlier if a third party proposes to acquire control of the Group). The Warrants comprise 155,780,375 Core Tranche Warrants with an exercise price of € 0.975 per share and 138,471,444 Secondary Tranche Warrants with an exercise price of € 0.375 per share.

The Warrants are not transferable, except to a Government entity, without the prior written consent of the Group and will not be listed or quoted on any stock exchange. The NPRFC will be entitled to exercise no more than 50% of the voting rights attaching to any ordinary shares issued as a result of exercising the Warrants. If those ordinary shares are transferred to any person other than a Government entity, full voting rights will attach to those shares.

For so long as the NPRFC holds 2009 Preference Shares or 2009 Warrants, subject to certain exceptions, the consent of the Minister will be required for the passing of certain share capital resolutions of the Company, being resolutions relating to: (i) an increase in the authorised share capital; (ii) a re-issue of Treasury Shares; (iii) the issue of any shares; or (iv) the redemption, consolidation, conversion or sub-division of the share capital.

Deferral of coupon payments

In December 2009, the Board resolved that the non-cumulative distribution on the Stg£ 350 million Fixed Rate/Floating Rate Guaranteed Non-voting Non-cumulative Perpetual Preferred Securities of AIB UK 3 LP which has the benefit of a subordinated guarantee of AIB ('the LP3 Preferred Securities'), which otherwise would have been paid on 14 December 2009, would not be paid.

The effect of this decision by the Group was to trigger the 'Dividend Stopper' provisions of the LP 3 Preferred Securities, which precludes the Group for a period of one calendar year from and including 14 December 2009, from declaring and paying any distribution or dividend on its 'Junior Share Capital', an expression which, at the moment, comprises the Group's ordinary shares and the Irish Government € 3.5 billion preference shares ('the Preference Shares') issued on 13 May 2009 to the NPRFC.

The Group is similarly precluded, for the same period of time, from declaring and paying any distribution or dividend (or, where applicable, is bound to procure that no distribution or dividend is declared or paid) on any 'Parity Security', an expression which, at the moment, comprises the Group's 7.5% Step-up Callable Perpetual Reserve Capital Instruments on which an annual Coupon Payment was due on 28 February 2010, the Fixed Rate/Floating Rate Guaranteed Non-Voting Non-Cumulative Perpetual Preferred Securities issued by AIB UK 1 LP ('the LP 1 Preferred Securities') on which an annual non-cumulative distribution was due on 17 December 2009 and the Fixed Rate/Floating Rate Guaranteed Non-Voting Non-Cumulative Perpetual Preferred Securities issued by AIB UK 2 LP ('the LP 2 Preferred Securities') on which an annual non-cumulative distribution would otherwise be due on 16 June 2010. Further information and analysis is available in the 2009 Annual Financial Report on the Group's website (www.aibgroup.com).

Glossary of definitions and explanations

A

AIB Group (UK) p.l.c. is a wholly owned subsidiary which trades in Northern Ireland as First Trust Bank (approximately 48 branches and outlets) and in Britain as Allied Irish Bank (GB) (31 branches and 1 development office).

B

Banking book (also *non-trading book*) – The Group’s banking book consists of its retail and corporate deposit books, Global Treasury’s cash books and the Group’s investment portfolios and derivatives hedging interest rate risk within these portfolios.

BZWBK – In Poland, the AIB Group operates from 512 branches and 89 agency outlets, primarily in Western Poland, through its 70.4 per cent, owned subsidiary Bank Zachodni WBK S.A.

C

CCE – Counterparty credit exposure is an exposure or a potential credit exposure that may, for example, take the form of a loan of cash or securities (where the counterparty would traditionally be called the borrower), of securities posted as collateral, of a commitment or of exposure under an over the counter (“OTC”) derivatives contract.

CCF – Credit Conversion Factor converts off balance sheet items and items which are committed but undrawn into on balance sheet credit exposure equivalents.

CIU – Collective Investment Undertakings is an exposure class and includes:

- i. undertakings where the sole object is the collective investment in transferable securities of capital raised from the public and which operate on the principle of risk-spreading; and
- ii. units which are, at the request of the holders, repurchased or redeemed, directly or indirectly, out of those undertakings’ assets. Action taken by a CIU to ensure that the stock exchange value of its units does not vary significantly from their net asset value shall be regarded as equivalent to such repurchase or redemption.

Conversion factor – the ratio of the currently undrawn amount of a commitment that will be drawn and outstanding at default to the currently undrawn amount of the commitment, the extent of the commitment shall be determined by the advised limit, unless the unadvised limit is higher.

CRM – Credit Risk Mitigation is a technique used by a credit institution to reduce the credit risk associated with an exposure or exposures which the credit institution continues to hold.

CSA – Credit Support Annexes provide credit protection by setting forth the rules governing the mutual posting of collateral. CSAs are used in documenting collateral arrangements between two parties that trade over-the-counter derivative securities. The trade is documented under a standard contract called a master agreement, developed by ISDA. The two parties must sign the ISDA master agreement and execute a credit support annex before they trade derivatives with each other.

D

Dilution risk – the risk that an amount receivable is reduced through cash or non-cash credits to the obligor.

E

EAD – Exposure at default represents the institution’s best estimate of its expected gross exposure for each facility upon a borrower’s default, giving full recognition to drawn and undrawn credit lines and regardless of whether such undrawn lines are committed or advised lines.

Economic loss – includes material discount effects, and material direct and indirect costs associated with collecting on the instrument.

EL – Expected Loss the ratio of the amount expected to be lost on an exposure from a potential default of a counterparty or dilution over a one year period to the amount outstanding at default.

Exposure value – for on balance sheet exposures, is the amount outstanding less provisions and collateral held taking into account relevant netting agreements. No account is taken of the residual

maturity or ratings from external credit rating agencies. For commitments and guarantees, it is the amount outstanding less provisions and collateral held taking into account relevant netting agreements and credit conversion factors.

Eligible financial collateral – is any of the following¹

- (a) cash on deposit with, or cash assimilated instruments held by, the lending credit institution;
- (b) debt securities issued by central governments or central banks, which securities have a credit assessment by an ECAI or export credit agency recognised as eligible for the purposes of Articles 78 to 83 which has been determined by the competent authority to be associated with credit quality step 4 or above under the rules for the risk weighting of exposures to central governments and central banks under Articles 78 to 83;
- (c) debt securities issued by institutions, which securities have a credit assessment by an eligible ECAI which has been determined by the competent authority to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to credit institutions under Articles 78 to 83;
- (d) debt securities issued by other entities, which securities have a credit assessment by an eligible ECAI which has been determined by the competent authority to be associated with credit quality step 3 or above under the rules for the risk weighting of exposures to corporates under Articles 78 to 83;
- (e) debt securities with a short-term credit assessment by an eligible ECAI which has been determined by the competent authority to be associated with credit quality step 3 or above under the rules for the risk weighting of short term exposures under Articles 78 to 83;
- (f) equities or convertible bonds that are included in a main index; and
- (g) gold

ECAI – External Credit Assessment Institution is a body which rates securities or debt offered by way of a public issue. The national supervisors are responsible for determining whether an ECAI meets the eligibility criteria listed in paragraph 91 of the paper “International Convergence of Capital Measurement and Capital Standards” issued by the Basel Committee in November 2005 (Basel II), so that banks incorporated in their jurisdictions can use the ECAIs risk assessments for the calculation of capital requirement under Basel II.

F

Fair value – according to the International Financial Reporting Standards (“IFRS”), fair value is the amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arms length transaction.

Financial Regulator – The Financial Regulator, in Ireland, was established on 1 May 2003 following a government decision to set up the Central Bank of Ireland as the Central Bank and Financial Services Authority of Ireland. The structure combines two distinct component entities - the Central Bank and the Financial Regulator – each with its own particular set of responsibilities and each with its own specific governance structure. The Central Bank’s responsibilities include surveillance of the strengths and vulnerabilities of the overall economy and financial system. The Financial Regulator’s remit includes monitoring the financial soundness of individual institutions, in addition to wide-ranging consumer protection powers.

G

Gross exposure – gross exposure is the exposure at default before Credit Risk Mitigation (“CRM”), Credit Conversion Factors (“CCF”) and other offsets. See Credit Risk Mitigation and Credit Conversion Factor defined above.

I

ISDA – International Swaps and Derivatives Association. ISDA represents participants in the privately negotiated derivatives industry, is the largest global financial trade association, by number of member firms.

¹Annex VIII, 1.3.1 of Directive 2006/48/EC

Items belonging to regulatory high risk categories:¹

- Paragraph 66. Subject to the discretion of competent authorities, exposures associated with particularly high risks such as investments in venture capital firms and private equity investments shall be assigned a risk weight of 150 %.
- Paragraph 67. Non past due items may be assigned a 150 % risk weight according to the provisions of this Part and for which value adjustments have been established may be assigned a risk weight of: (a) 100 %, if value adjustments are no less than 20 % of the exposure value gross of value adjustments; and (b) 50 %, if value adjustments are no less than 50 % of the exposure value gross of value adjustments.

L

LGD – Loss given default is the ratio of the loss on an exposure due to the default of a counterparty to the amount outstanding at default.

M

Market value – the market price is the prevailing price at which goods and/or services may be bought or sold in the open market.

N

NAMA – National Assets Management Agency.

NPRFC – National Pension Reserve Fund Commission

NTMA – The National Treasury Management Agency

O

Operational risk – is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events, and includes legal risk.

Originator – is either of the following:

- (a) an entity which, either itself or through related entities, directly or indirectly, was involved in the original agreement which created the obligations or potential obligations of the debtor or potential debtor giving rise to the exposure being securitised;
- (b) an entity which purchases a third party's exposures onto its balance sheet and then securitises them.

Other items – refers to other assets including land and buildings, plant and machinery, other fixtures and fittings, tools and equipment, payments on account and tangible assets in the course of construction.

P

Past due items – the Basel standardised asset class '*Past due items*' only includes exposures that are (a) Standardised, and (b) greater than 90 days past due or defaulted.

PD – Probability of Default is the probability of default of a counterparty over a one year period.

R

Revolving exposure – an exposure whereby customers' outstanding balances are permitted to fluctuate based on their decisions to borrow and repay, up to an agreed limit, and an early amortisation provision shall be a contractual clause which requires, on the occurrence of defined events, investors' positions to be redeemed before the originally stated maturity of the securities issued.

Risk weighted assets – A measure of assets (including off-balance sheet items converted into asset equivalents e.g. credit lines) which are weighted in accordance with prescribed rules and formulae as defined in the Basel Accord to reflect the risks inherent in those assets.

RMBS - Residential mortgage-backed securities are debt obligations that represent claims to the cash flows from pools of mortgage loans, most commonly on residential property.

¹Annex VI Standardised Approach; Directive 2006/48/EC.

S

Securitisation - a transaction or scheme, whereby the credit risk associated with an exposure or pool of exposures is tranching, having the following characteristics:

- (a) payments in the transaction or scheme are dependent upon the performance of the exposure or pool of exposures; and
- (b) the subordination of tranches determines the distribution of losses during the ongoing life of the transaction or scheme.

Securitisation position – an exposure to a securitisation.

Sponsor – a credit institution other than an originator credit institution that establishes and manages an asset backed commercial paper programme or other securitisation scheme that purchases exposures from third party entities.

Synthetic securitisation – a securitisation where the transfer of risk is achieved by the use of credit derivatives or guarantees and the pool of exposures is not removed from the balance sheet of the originator credit institution.

T

Total exposure – see exposure value.

Trading book – The interest rate trading book includes all securities and interest rate derivatives that are held for trading purposes in Global Treasury. These are revalued daily at market prices (market to market) and any changes in value are immediately recognised in income.

Traditional securitisation – a securitisation involving the economic transfer of the exposures being securitised to a securitisation special purpose entity which issues securities. This is accomplished by the transfer of ownership of the securitised exposures from the originator credit institution or through sub-participation. The securities issued do not represent payment obligations of the originator credit institution.