# Bank of Ireland Mortgage Bank

## Annual Report

2018

Bank of Ireland Group

# Bank of Ireland Mortgage Bank

## Annual Report

for the year ended 31 December 2018

# Contents


| Index | Page |
|---|---|
| Directors and other information | 4 |
| Report of the Directors | 5 |
| Statement of Directors' responsibilities | 8 |
| Corporate governance statement | 9 |
| Independent auditor's report | 10 |
| Income statement | 13 |
| Statement of comprehensive income | 14 |
| Balance sheet | 15 |
| Statement of changes in equity | 16 |
| Notes to the financial statements | 17 |
| Glossary | 73 |
| Abbreviations | 74 |


**View this report online**

*This Annual Report and other information relating to Bank of Ireland is available at:*

*www.bankofireland.com*

# Directors and other information

**Directors at date of signing**
Harry Lorton
John O'Beirne
Neil Corcoran
Aine McCleary
Tony McMahon
Tony Morley
Sean Crowe
Geraldine Kelly
Richard Milliken

**Registered Office and Number**
Bank of Ireland Mortgage Bank
New Century House
Mayor Street Lower
IFSC
Dublin 1
Registered Number 386415

**Cover Assets Monitor**
Mazars
Harcourt Centre
Block 3
Harcourt Road
Dublin 2

**Independent Auditor**
KPMG
1 Harbourmaster Place
IFSC
Dublin 1

**Secretary**
Hill Wilson Secretarial Limited
Bank of Ireland
40 Mespil Road
Dublin 4

# Report of the Directors

The Directors hereby present their report, together with the audited financial statements of Bank of Ireland Mortgage Bank (the 'Bank'), for the financial year ended 31 December 2018.

## Review of business

The Bank's principal activities are the provision of Irish residential mortgages and the issuance of securities in accordance with the Asset Covered Securities Acts, 2001 to 2007 (the 'ACS Acts').

The Bank is a wholly owned subsidiary of The Governor and Company of the Bank of Ireland ('Bank of Ireland'). The Bank's ultimate holding company is Bank of Ireland Group plc. Bank of Ireland Group plc and its subsidiaries constitute the Bank of Ireland Group (the 'Group').

The underlying performance of the Bank has been strong in 2018 and among the highlights were:

- underlying net interest income[1] of €313 million (2017: €305 million);
- growth in the Irish new mortgage market of 20% to €8.7 billion[2], with the Bank maintaining its new lending market share at 27%;
- strong demand for fixed interest rate mortgages both by existing and new customers which provide value, certainty and stability for both our customers and the Bank; and
- an improvement in asset quality with a reduction in non-performing exposures of 16% to €1.5 billion.

The outlook for the Irish economy remains positive with strong domestic activity and robust exports during 2018. The strong labour market performance in 2017 has carried forward into 2018 with unemployment declining to a rate of 5.3%, with c.20,000 jobs (net) being created in 2018. This increase in employment levels is having a positive impact on incomes and consumer spending continues to increase.

The improving economic conditions coupled with a growing population have resulted in increased demand for property. The number of residential transactions in the market was up 3% in 2018 while house price inflation also continues to grow, increasing by 6.5% in 2018. New mortgage lending was up 20% year on year and while there are signs that house building activity is also picking up, there continue to be supply constraints in the housing market, particularly in the greater Dublin and other urban areas.

*Tracker Mortgage Examination Review*

As at 31 December 2017, the Bank held a provision of €123 million in respect of the Bank's ongoing Tracker Mortgage Examination Review. The provision represented the Bank's best estimate of the redress and compensation due to impacted customers and the costs to be incurred by the Bank in connection with the Review. During 2018, the Bank made considerable progress in contacting and remediating the majority of the remaining impacted customers. Since 31 December 2017, €85 million of the provision has been utilised covering redress, compensation and related costs leaving a residual provision of €38 million at 31 December 2018. The Central Bank has initiated administrative sanctions proceedings in respect of the Bank and a number of other institutions in respect of tracker mortgages.

Resolving the Bank's Tracker Mortgage Examination Review and ensuring that all impacted customers are remediated remains a key priority for the Bank. At 31 December 2018, offers of redress and compensation have been made to 97% of impacted customers. The Bank expects to complete all payments to the remaining account holders, subject to their agreement during 2019.

While the redress and compensation element of the provision is largely known, there are still a number of uncertainties as to the eventual total cost of the examination and the administrative sanctions proceedings. Management has therefore exercised judgement to determine the appropriate provision.

*Asset quality*

Loans and advances to customers (before impairment loss allowances) at amortised cost amounted to €16.0 billion at 31 December 2018 (2017: €15.4 billion).

The 2018 figure excludes Life Loans of €0.3 billion which were reclassified to 'other financial assets at fair value through profit or loss' on transition to IFRS 9.

Non-performing exposures have reduced by 16% to €1.5 billion at 31 December 2018 (2017: €1.8 billion). Expected credit losses measured under IFRS 9 are €0.3 billion (2017: impairment provisions under IAS 39 were €0.5 billion).

The Bank's good progress in effecting sustainable restructure and resolution strategies for customers in financial difficulties has contributed to a significant reduction in the stock of non-performing exposures in 2018.

The Bank continues to offer a range of forbearance measures to customers in arrears or facing potential arrears on contracted mortgage repayments in order to arrange, where viable, sustainable repayment solutions. Forbearance occurs when a borrower is granted an agreed change ('forbearance measure') to the contractual terms of a mortgage loan for reasons relating to the actual or apparent financial stress or distress of that borrower. An exposure continues to be classified as forborne until such time as it satisfies conditions to exit forbearance in line with European Banking Authority (EBA) guidance. Loans that have never been forborne and loans that are no longer required to be reported as 'forborne', are classified as 'non-forborne loans'.

Owner occupied non-performing exposures were €0.8 billion at 31 December 2018, a reduction of 17% since 31 December 2017. This reduction is reflective of the improvement in economic conditions during the year and the ongoing progress being made by the Bank in effecting its mortgage arrears resolution strategies. At 31 December 2018, 97% of the Owner occupied mortgage book was on a 'full principal and interest' repayment basis (2017: 97%).

Buy to let non-performing exposures were €0.7 billion at 31 December 2018, a reduction of 16% since 31 December 2017. This reduction reflects the continued progress made by the Bank in the ongoing restructuring of customer mortgages and resolution activity, supported by improved rental market conditions, particularly evident in primary urban areas. At 31 December 2018, 79% of the Buy to let mortgage book was on a 'full principal and interest' repayment basis (2017: 77%).

*Introduction of IFRS 9*

As of 1 January 2018, IFRS 9 'Financial instruments' came into effect and has been applied in the preparation of the

[1] *Underlying net interest income is net interest income excluding the impact of the Tracker Mortgage Examination Review and comprises underlying interest income of €435 million (see note 3) (2017: €505 million) less interest expense €122 million (see note 4) (2017: €200 million).*

[2] *BPFI new mortgage data.*

Bank's financial statements. Comparative figures have not been restated for the impact of IFRS 9 and are presented on an IAS 39 classification and measurement basis. On transition to IFRS 9, the Bank's reserves increased by €36 million. See notes 2 and 31 for further information on the impact of transition to IFRS 9.

*Capital*

At 31 December 2018, the common equity tier 1 (CET 1) ratio on a regulatory basis was 18.9% (2017: 20.2%) and on a fully loaded basis was 18.9% (2017: 19.8%). The total capital ratio on a regulatory basis was 24.5% (2017: 27.0%). The movement in the Bank's capital ratios is due to profits for the year being outweighed by the impact of the European Central Bank (ECB) Targeted Review of Internal Models (TRIM) relating to Irish mortgages. The TRIM review is now complete and resulted in a reduction of c.880 basis points in the Bank's total capital ratio.

The leverage ratio at 31 December 2018 was 6.7% on a regulatory basis (2017: 6.8%) and 6.7% on a fully loaded basis (2017: 6.7%). The Bank expects to remain above the European Commission proposed leverage ratio requirement of 3% which is expected to be applicable from 2021.

The Bank will be required to maintain a Countercyclical Buffer (CCyB) from 5 July 2019. See the section on 'Capital management' in note 27 on page 61 for further details.

*Principal risks and uncertainties*

The principal risks that the Bank is exposed to are Credit Risk, Market Risk, Funding and Liquidity Risk, Operational Risk, Regulatory Risk, Conduct Risk, Business and Strategic Risk, Reputation Risk and Capital Adequacy Risk. The financial risk management objectives and policies of the Bank, including the policy for hedging, and the exposure of the Bank to these key risks is set out in note 27 Risk management and control.

*Brexit*

Ongoing uncertainty following the UK vote to exit the EU, relating to the nature and impact of withdrawal, could impact the markets in which the Bank operates. This includes pricing, customer confidence and credit demand, collateral values and customers' ability to meet their financial obligations. This, in turn, could have an impact on the Bank's financial performance, balance sheet, capital and dividend capacity.

Other effects may include changes in official interest rate policy in the Eurozone, which can impact the Bank's revenues. The Bank continues to closely monitor the impact on the Irish economy and the Bank, and manage that change, and the specific risks and challenges associated with same.

*Results*

The profit before taxation for 2018 amounted to €342 million (2017: loss before taxation of €227 million), as set out in the income statement on page 13.

The underlying Net Interest Income[1] (NII) increased to €313 million for 2018, from €305 million in 2017. The increase in underlying NII is primarily driven by lower funding costs.

Fee and commission income amounted to €2 million for 2018 (2017: €1 million).

Operating expenses decreased to €27 million for 2018 (2017: €107 million) driven primarily by a decrease in costs associated with the Tracker Mortgage Examination Review. Excluding the impact of this Review, operating expenses decreased to €38 million (2017: €46 million) reflecting reduced administrative expenses associated with the management of the loan portfolios.

The net impairment gains of €43 million for 2018 (2017: €98 million) reflect improved economic conditions, the continued improvement in the credit quality of our loan book and our actions to manage non-performing exposures. Details of updated impairment measurement and assumptions for the loan portfolio, including property valuation assumptions are set out on page 51.

Net trading income for the year was €22 million (2017: €3 million expense), which reflects the impact of fair value movements on Life Loans classified at fair value through profit or loss under IFRS 9 of €15 million and the fair value movements on swaps of €7 million. The Bank enters into derivative transactions only for the hedging of interest rates. Net trading income includes fair value movements on both derivatives and debt securities in a fair value hedge relationship and interest flows and fair value movements on derivatives which do not qualify for hedge accounting.

*Funding*

The Bank has an approved funding policy that includes funding directly through the use of asset backed securities, mortgage-backed promissory note programmes and borrowings from the Group. The Bank also has the ability to access secured funding through the tendering operations of the ECB.

Covered bonds are a key element of the Bank's long term funding strategy. During 2018, the Bank issued €2.1 billion asset covered securities and €0.7 billion of securities in issue matured.

The Bank obtains a rating for the covered bonds from Moody's Investor Services, 2018: Aaa (2017: Aa1).

At 31 December 2018, the Bank had a customer loan portfolio of €15.9 billion (net of impairment loss allowances and including Life Loans) funded through debt securities in issue: €8.3 billion (52%); capital and subordinated debt: €1.7 billion (11%) and net Group borrowings: €5.9 billion (37%). Of the €8.3 billion debt securities in issue, €3.2 billion is held by Bank of Ireland. The remaining €5.1 billion is issued to external bondholders with a range of maturities out to 2043.

Full details of debt securities in issue are contained in note 18 to the financial statements.

At 31 December 2018, the Bank had €140 million of subordinated loan borrowings from its immediate parent company (2017: €141 million).

*Accounting records*

The measures taken by the Directors to secure compliance with the Bank's obligation to keep adequate accounting records are the use of appropriate systems, the implementation of robust controls and procedures and the employment of competent persons with relevant experience. The accounting records are kept at the Bank's registered office.

*Disclosure of information to auditors*

The Directors in office at the date of this report have confirmed that, as far as they are aware:

- there is no relevant audit information of which the Bank's auditor is unaware; and

[1] *Underlying net interest income is net interest income excluding the impact of the Tracker Mortgage Examination Review and comprises underlying interest income of €435 million (see note 3) (2017: €505 million) less interest expense €122 million (see note 4) (2017: €200 million).*

- they have taken all the steps that ought to be taken, as Directors, in order to make themselves aware of any relevant audit information and to establish that the Bank's auditor is aware of that information.

***Dividends***
No dividends were paid during 2018 (2017: €nil). The Directors do not recommend the payment of a dividend.

***Audit committee***
The Bank's Audit Committee, which comprises a majority of independent non-executive Directors, assists the Board of Directors (the 'Board') in fulfilling its responsibilities relating to:

- the integrity of the financial statements;
- the relationship between the Bank and its external auditors;
- the Bank's internal controls, internal audit and IT systems; and
- compliance functions.

***Outlook***
Notwithstanding Brexit uncertainties, the positive economic environment in Ireland is expected to continue and forward looking indicators suggest that we will see continued growth in mortgage lending in 2019. Forecasts out to 2021 indicate that the Bank will continue to grow its loan book and generate sustainable profits and capital over the period.

***Directors and Secretary***
Harry Lorton
*Independent Non-executive Chairman*

John O'Beirne
*Managing Director*

Neil Corcoran
*Executive Director*

Stephen Mason
*Executive Director*
*(Resigned 30 June 2018)*

Tony McMahon
*Executive Director*
*(Appointed 9 October 2018)*

Aine McCleary
*Group Non-executive Director*
*(Appointed 14 January 2019)*

Tony Morley
*Group Non-executive Director*
*(Appointed 14 January 2019)*

Sean Crowe
*Group Non-executive Director*

Geraldine Kelly
*Independent Non-executive Director*

Liam McLoughlin
*Group Non-executive Director*
*(Resigned 31 January 2018)*

Richard Milliken
*Independent Non-executive Director*

***Directors' and Secretary's interests***
The Directors and Secretary had no interests in the shares of the Bank or any other Group company that are required by the Companies Act 2014 to be recorded in the register of interests or disclosed in the Report of the Directors.

***Political donations***
Political donations are required to be disclosed under the Electoral Acts 1992 to 2012. The Directors, on enquiry, have satisfied themselves that there were no political donations made during 2018 (2017: €nil).

***Corporate governance***
The Corporate governance statement on page 9 forms part of the Report of the Directors.

***Going concern***
The Directors consider it appropriate to prepare the financial statements on a going concern basis having concluded that there are no material uncertainties related to events or conditions that may cast significant doubt on the Bank's ability to continue as a going concern over the period of assessment. The considerations assessed are set out on page 18 in the going concern disclosure within the accounting policies in note 1 to the financial statements.

***Post balance sheet events***
On 10 January 2019, the ECB approved a reduction of €250 million of ordinary share capital in the Bank by means of the cancellation of 250 million of ordinary shares at par of €1 each. The Bank has a significant capital surplus above its risk appetite and its regulatory requirements which is not efficient and has a negative impact on Return on Total Equity. The capital reduction results in a distribution of €250 million to its immediate parent company, the Governor and Company of the Bank of Ireland and reduces CET 1 capital in the Bank by c. 4%. Following the reduction in share capital, the Bank will continue to have an adequate surplus over risk appetite and regulatory requirements. The reduction in share capital and distribution to the immediate parent was completed in January 2019.

There are no other post balance sheet events that require disclosure in the financial statements.

***Independent auditor***
KPMG was appointed on 17 July 2018 as the Bank's external auditor to conduct the Bank's audit for the year ended 31 December 2018. KPMG has expressed willingness to be re-appointed in accordance with Section 383(2) of the Companies Act 2014.

| **Harry Lorton**<br>*Chairman* | **John O'Beirne**<br>*Managing Director* | **Neil Corcoran**<br>*Director* | **Hill Wilson**<br>**Secretarial Limited** |
|---|---|---|---|

22 February 2019

# Statement of Directors' responsibilities

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

Company law requires the Directors to prepare financial statements for each financial year. Under that law the Directors are required to prepare the financial statements in accordance with FRS 101 Reduced Disclosure Framework.

Under company law the Directors must not approve the financial statements unless they are satisfied that they give a true and fair view of the assets, liabilities and financial position of the Bank and of its profit or loss for that year. In preparing these financial statements, the Directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgements and estimates that are reasonable and prudent;
- state whether applicable Accounting Standards have been followed, subject to any material departures disclosed and explained in the financial statements;
- assess the Bank's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and
- use the going concern basis of accounting unless they either intend to liquidate the Bank or to cease operations, or have no realistic alternative but to do so.

The Directors are responsible for keeping adequate accounting records which disclose with reasonable accuracy at any time the assets, liabilities, financial position and profit or loss of the Bank and which enable them to ensure that the financial statements of the Bank comply with the provisions of the Companies Act 2014. They are responsible for such internal controls as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error, and have general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Bank and to prevent and detect fraud and other irregularities. The Directors are also responsible for preparing a directors report that complies with the requirements of the Companies Act 2014.

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

**Harry Lorton**
*Chairman*

**John O'Beirne**
*Managing Director*

**Neil Corcoran**
*Director*

22 February 2019

# Corporate governance statement

**Introduction**
A key objective of the Bank's governance framework is to ensure compliance with applicable legal and regulatory requirements. The Bank is subject to the Central Bank of Ireland Corporate Governance Requirements for Credit Institutions 2015 with effect from 11 January 2016 (the 'Code'). The Bank is also subject to the additional requirements of Appendix 1 of the Code for High Impact designated credit institutions.

The Directors believe that the Bank complied with the provisions of the Code throughout 2018. (The Code is available at www.centralbank.ie).

**Financial reporting process**
The Board, supported by the Audit Committee, is responsible for establishing and maintaining adequate internal control and risk management systems of the Bank in relation to the financial reporting process. Such systems are designed to manage rather than eliminate the risk of failure to achieve the Bank's financial reporting objectives and can only provide reasonable and not absolute assurance against material misstatement or loss. The Board has established processes regarding internal control and risk management systems to ensure its effective oversight of the financial reporting process. The Bank's overall control system around the financial reporting process includes:

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

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

**Risk assessment**
The Board is responsible for assessing the risk of irregularities whether caused by fraud or error in financial reporting and ensuring the processes are in place for the timely identification of internal and external matters with a potential effect on financial reporting. The Board has also put in place processes to identify changes in accounting rules and recommendations and to ensure that these changes are accurately reflected in the Bank's financial statements.

**Control activities**
The Board is responsible for establishing and maintaining the design and implementation of control structures to manage the risks which they judge to be significant for internal control over financial reporting. Appropriate reconciliations support the prompt production of management accounts and Board reports and inputs to Group consolidation returns that are required to be submitted within defined timetables.

These control structures include appropriate division of responsibilities and specific control activities, with the objective of detecting or preventing the risk of significant deficiencies in financial reporting for every significant account in the financial statements and the related notes in the Bank's annual report.

The Audit Committee monitors the effectiveness and adequacy of the Bank's internal control, internal audit and IT systems, and reviews the effectiveness and adequacy of the Bank's regulatory compliance plan with the objective of maintaining an effective system of internal control. The composition and responsibilities of the Audit Committee are also outlined in the Report of the Directors.

**Monitoring**
The Board ensures that appropriate measures are taken to consider and address any shortcomings identified and measures recommended by the independent auditors.

The Group Internal Audit function performs a review of controls and procedures employed by the Bank. This enables the Board to perform effective monitoring and oversight of the internal control and risk management systems of the Bank in relation to the financial reporting process. The Board ensures that appropriate measures are taken to consider and address any shortcomings identified and measures recommended by these internal audits.

## Report on the audit of the financial statements

### Opinion

We have audited the financial statements of Bank of Ireland Mortgage Bank (‘the Company’) for the year ended 31 December 2018 set out on pages 13 to 72, which comprise of the income statement, the statement of comprehensive income, the balance sheet, the statement of changes in equity and related notes, including the summary of significant accounting policies, set out in note 1. The financial reporting frameworks which have been applied in their preparation are Irish Law and FRS 101 *Reduced Disclosure Framework.*

In our opinion, the accompanying financial statements:

- give a true and fair view of the assets, liabilities and financial position of the Company as at 31 December 2018 and of its profit for the year then ended;
- have been properly prepared in accordance with FRS 101 *Reduced Disclosure Framework*; and
- have been properly prepared in accordance with the requirements of the Companies Act 2014.

### Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (Ireland) (ISAs (Ireland)) and applicable laws. Our responsibilities under these standards are further described in the Auditor’s Responsibilities section of our report. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion. Our audit opinion is consistent with our reporting to the Audit Committee.

We were appointed as auditor by the directors on 17 July 2018. The period of total uninterrupted engagement is therefore one year for the year ended 31 December 2018. We have fulfilled our ethical responsibilities and have remained independent of the Company, in accordance with the ethical requirements applicable in Ireland, including the Ethical Standard issued by the Irish Auditing and Accounting Supervisory Authority (IAASA), as applied to public interest entities. Any non-audit services prohibited by this standard were not provided.

### Other matter – first year audit considerations

Prior to the commencement of the current financial year, and our formal appointment on 17 July 2018, we were required to become independent of the Company. During this time, we met with management across the Company to understand the business and to gather the information needed to plan our first audit effectively. We met with the former auditor and attended the Audit Committee meetings throughout the 2017 audit cycle to understand the key audit matters as, and when, they arose. We assessed the audit working papers of the former auditor to gain sufficient audit evidence as to whether the opening balances contained misstatements that could materially affect the current year financial statements.

### Key audit matters: our assessment of risks of material misstatement

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

In arriving at our audit opinion above, the key audit matters, in decreasing order of audit significance, were as follows:

## Impairment loss allowance under IFRS 9 Financial Instruments

*Refer to pages 22 to 24 (accounting policy) and pages 37 to 39 (financial disclosures)*

### The key audit matter

The calculation of credit provisions requires a high degree of judgement to reflect recent developments in credit quality, arrears experience, and emerging macroeconomic risks.

On 1 January 2018 the Company adopted IFRS 9. This is a new and complex accounting standard which has required considerable judgement and interpretation in its implementation. These judgements have been key in the development of the new IFRS 9 models which have been built and implemented to measure the expected credit losses on loans measured at amortised cost.

The key areas where we identified greater levels of management judgement and, therefore, increased levels of audit focus in the Company’s implementation of IFRS 9 include but are not limited to:

- ***Accuracy of Expected Credit Loss (ECL) models:*** The calculation of ECLs uses complex and inherently judgemental modelling techniques. The models used in the various loan portfolios are the key drivers of the Company’s ECL results and are, therefore, the most significant judgmental aspect of the Company’s ECL modelling approach.
- ***Significant Increase in Credit Risk (SICR):*** The criteria selected to identify a significant increase in credit risk is a key area of judgement within the Company’s ECL calculation. The application of the criteria relies on a significant number of data elements, which form the basis of modelling ECL. The application of the appropriate criteria and accuracy of the key data elements used in the loan processes are significant in determining the ECL allowances.
- ***Forward looking macroeconomic scenarios:*** IFRS 9 requires the Company to measure ECLs on a forward-looking basis, reflecting future economic conditions. Significant management judgment is applied to determining the economic scenarios used and the probability weightings applied to them, particularly given these assessments are subject to material uncertainty due to Brexit. The impact of Brexit is subject to unprecedented levels of uncertainty of outcomes, with the full range of possible effects unknown.
- ***Management adjustments:*** Adjustments to the model-driven ECL results are applied by management to address known impairment model limitations or emerging trends. Such adjustments are inherently uncertain and significant management judgment is involved.

### How the matter was addressed in our audit

- We performed end-to-end process walkthroughs to identify the key systems, applications and controls used in the ECL processes. We tested the design and operating effectiveness of the key controls over the completeness and accuracy of the key data inputs to the impairment models.
- In conjunction with our modelling specialists, we tested the design and implementation of controls over the modelling process and methodologies, including model monitoring, validation and approval, as well as testing the design of controls over model outputs and recognition and approval of post model adjustments.
- We tested the design and implementation of key controls relating to the selection and implementation of material economic variables and the controls over the associated scenario selection and probability weightings applied to them.

- We tested SICR criteria relating to the authorisation of the criteria, the validation metrics, and the application of the criteria in the models.
- We re-performed key aspects of the Company's SICR calculations and selected samples of financial instruments to determine whether a SICR was appropriately identified.
- We assessed the appropriateness of the key judgements in the ECL models and tested the key controls over the loss rate ECL calculations.
- We compared the forward looking macroeconomic information against industry forecasts and the inputs used by management in order to determine the base case and upside and downside scenarios.
- We assessed the adequacy of post model adjustments, having regard for the risk profile of loans, recent loss history and performance of the relevant portfolios and key uncertainties, such as Brexit. We challenged whether the modelled collective impairment provision already appropriately reflected the assumptions underpinning these adjustments or if a management adjustment was required.

The results of our testing were satisfactory and we found the ECL charge and provision recognised to be acceptable.

**Conduct Risk: The Company's provision in respect of the Tracker Mortgage Examination (TME) of €38 million (2017: €123 million)**

*Refer to page 28 (accounting policy) and pages 43 to 44 (financial disclosures)*

**The key audit matter**

In December 2015, the Central Bank of Ireland requested that the Company conduct an examination of its Irish mortgage loan book to assess compliance with both the Company's legal obligation and the applicable regulatory framework. The prior year financial statements included provisions arising from the output of this examination at this time.

At 31 December 2018, the Company's provision in respect of the TME is €38 million. This primarily relates to remaining redress and compensation to be paid to customers and programme costs, including estimation of potential fines arising from the conclusion of the CBI examination. Whilst the level of estimation uncertainty associated with the TME has decreased, there are certain key assumptions which remain judgemental, specifically the quantum of potential fine that will be imposed by the CBI.

We consider this to be a key audit matter because of its materiality to the financial statements and the significant uncertainties and judgments inherent in its estimation.

**How the matter was addressed in our audit**

Our procedures included:

- We read relevant correspondence between the CBI and the Company in relation to the TME and discussed the key matters with senior management and with those charged with governance at both the Bank of Ireland Group and Bank of Ireland Mortgage Bank. We considered the Group Internal Audit findings in respect of the matter.
- We obtained an understanding of the methodology used by management in the determination of the provision and assessed the design and implementation of controls relating to the provision calculation at year end.
- For key assumptions inherent in the provision at year end, we assessed the judgements made by management to determine whether they were reasonable.
- We reviewed the adequacy of disclosures in respect of the TME provision to determine whether they were consistent with our understanding and in line with the requirements of IAS 37 Provisions, Contingent Liabilities and Contingent Assets.

Based on the evidence obtained, we found that the provision and disclosures provided in respect of the TME are appropriate having regard for the requirements of IAS 37.

**Revenue recognition fraud risk – Effective Interest Rate (EIR) adjustments**

*Refer to pages 19 and 20 (accounting policy) and page 30 (financial disclosures)*

**The key audit matter**

The Company recognises interest income for loans and advances to customers at amortised cost using the effective interest method.

In determining the effective interest rate, management exercises judgment matters such as the expected life, expected cash flows and the appropriateness of how the cash flows are spread over the expected life.

These judgments are informed by product mix and past customer behaviour of when loans are repaid or refinanced, with the EIR balance and amount recognised in interest income being sensitive to changes in these assumptions.

Management utilise EIR models to determine revenue recognition in accordance with the requirements of IFRS 9.

Owing to the high degree of judgment and manual intervention within the EIR process, we considered it a significant risk.

**How the matter was addressed in our audit**

Our procedures included:

- We obtained an understanding and tested the design and implementation of key controls relating to the authorisation and review of the key assumptions regarding the EIR.
- We assessed the reasonableness of the key assumptions applied by management in determining the EIR, primarily the expected life, the expected cash flows and considered how those cash flows were forecasted over the expected life. We corroborated the expected life and expected cashflow assumptions to recent redemption experience of the Company and compared the assumptions to management's expectations of future customer payment patterns.
- We recalculated management's calculation of the impact of a change in expected life to determine if it was reasonable.

Overall, we found the key assumptions used in the calculation of the EIR to be appropriate and that the disclosures provide an adequate description of the critical assumptions and estimates made by the Company and the sensitivity to changes thereon.

**Our application of materiality and an overview of the scope of our audit**

The materiality for the financial statements, as a whole, was set at €14.6 million. This has been calculated as 4.3% of the benchmark of profit before tax, which we consider to be one of the principal considerations for users of the financial statements in assessing the financial performance of the Company.

We reported to the Audit Committee all corrected and uncorrected misstatements we identified through our audit with a value in excess of our posting threshold of €0.7 million in addition to other audit misstatements below that threshold that we believe warranted reporting on qualitative grounds.

***We have nothing to report on going concern***

We are required to report to you if we have concluded that the use of the going

concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

*Other information*
The directors are responsible for the other information presented in the Annual Report together with the financial statements. The other information comprises of the information included in the directors' report. The financial statements and our auditor's report thereon do not comprise part of the other information. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information.

Based solely on our work on the other information:
- we have not identified material misstatements in the directors' report;
- in our opinion, the information given in the directors' report is consistent with the financial statements; and
- in our opinion, the directors' report has been prepared in accordance with the Companies Act 2014.

*Corporate governance disclosures*
As required by the Companies Act 2014, we report, in relation to information given in the Corporate Governance Statement on page 9 that:
- based on the work undertaken for our audit, in our opinion, the description of the main features of internal control and risk management systems in relation to the financial reporting process, and information relating to voting rights and other matters required by the European Communities (Takeover Bids (Directive 2004/25/EC)) Regulations 2006 and specified for our consideration, is consistent with the financial statements and has been prepared in accordance with the Act; and
- based on our knowledge and understanding of the Company and its environment obtained in the course of our audit, we have not identified any material misstatements in that information.

We also report that, based on work undertaken for our audit, other information required by the Act is contained in the Corporate Governance Statement.

***Our opinions on other matters prescribed by the Companies Act 2014 are unmodified***
We have obtained all the information and explanations which we consider necessary for the purpose of our audit.

In our opinion, the accounting records of the Company were sufficient to permit the financial statements to be readily and properly audited and the Company's statement of financial position and profit and loss account is in agreement with the accounting records.

***We have nothing to report on other matters on which we are required to report by exception***

The Companies Act 2014 requires us to report to you if, in our opinion, the disclosures of directors' remuneration and transactions required by Sections 305 to 312 of the Act are not made.

**Respective responsibilities and restrictions on use**

*Directors' responsibilities*
As explained more fully in their statement set out on page 8, the directors are responsible for; the preparation of the financial statements including being satisfied that they give a true and fair view, such internal control as, they determine, is necessary to enable the preparation of financial statements to be free from material misstatement, whether due to fraud or error; assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Company or to cease operations, or have no realistic alternative but to do so.

*Auditor's responsibilities*
Our objectives are to obtain reasonable assurance as to whether the financial statements, as a whole, are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (Ireland) will always detect a material misstatement when it exists. Misstatements can arise from fraud, other irregularities or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. The risk of not detecting a material misstatement resulting from fraud, or other irregularities, is higher than for one resulting from error, as they may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control and may involve any area of law and regulation and not just those directly affecting the financial statements.

A fuller description of our responsibilities is provided on IAASA's website at https://www.iaasa.ie/getmedia/b2389013-1cf6-458b-9b8f-a98202dc9c3a/Description_of_auditors_responsiblities_for_audit.pdf

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

**David Moran**
for and on behalf of
**KPMG**
Chartered Accountants
1 Harbourmaster Place
IFSC, Dublin 1

22 February 2019

# Income statement

## for the year ended 31 December 2018

| | Note | 2018 €m | 2017[1] €m |
|---|---|---|---|
| Interest income calculated using the effective interest method | 3 | 424 | 431 |
| Interest expense | 4 | (122) | (200) |
| **Net interest income** | | **302** | **231** |
| Fee and commission income | | 2 | 1 |
| Net trading income / (expense) | 5 | 22 | (3) |
| **Total operating income** | | **326** | **229** |
| Operating expenses | 7 | (27) | (107) |
| **Total operating profit before net impairment gains on financial instruments** | | **299** | **122** |
| Net impairment gains on financial instruments | 8 | 43 | 98 |
| **Total operating profit** | | **342** | **220** |
| Net loss on derecognition of financial assets measured at amortised cost | 9 | - | (447) |
| **Profit / (loss) before taxation** | | **342** | **(227)** |
| Taxation (charge) / credit | 10 | (41) | 28 |
| **Profit / (loss) for the financial year** | | **301** | **(199)** |

The notes on pages 17 to 72 form an integral part of the financial statements.

[1] *Comparative figures have not been restated for the impact of IFRS 9.*

# Statement of comprehensive income

for the year ended 31 December 2018

| | **2018 €m** | 2017[1] €m |
|---|---|---|
| Profit / (loss) for the financial year | 301 | (199) |
| | | |
| **Other comprehensive income, net of tax** | | |
| *Items that may be reclassified to profit or loss in subsequent years:* | | |
| **Cash flow hedge reserve, net of tax** | | |
| - Changes in fair value | 35 | - |
| - Transfer to income statement | (18) | (19) |
| **Net change in cash flow hedge** | **17** | **(19)** |
| | | |
| **Total other comprehensive income, net of tax** | **17** | **(19)** |
| | | |
| **Total comprehensive income / (expense) for the year, net of tax** | **318** | **(218)** |

The notes on pages 17 to 72 form an integral part of the financial statements.

[1] *Comparative figures have not been restated for the impact of IFRS 9.*

# Balance sheet

## as at 31 December 2018

| | Note | 2018 €m | 2017[1] €m |
|---|---|---|---|
| **Assets** | | | |
| Derivative financial instruments | 11 | 109 | 73 |
| Other financial assets at fair value through profit or loss | 12 | 262 | - |
| Loans and advances to banks | 13 | 3,620 | 1,915 |
| Loans and advances to customers at amortised cost | 14 | 15,644 | 14,961 |
| Deferred tax asset | 16 | - | 34 |
| Current tax asset | 16 | 6 | 13 |
| Other assets | | 2 | 3 |
| **Total assets** | | **19,643** | **16,999** |
| | | | |
| **Liabilities** | | | |
| Deposits from banks | 17 | 9,473 | 8,458 |
| Debt securities in issue | 18 | 8,328 | 6,977 |
| Derivative financial instruments | 11 | 41 | 25 |
| Other liabilities | 19 | 21 | 36 |
| Deferred tax liability | 16 | 9 | - |
| Provisions | 20 | 38 | 123 |
| Loss allowance provision on loan commitments | 21 | - | - |
| Subordinated liabilities | 22 | 140 | 141 |
| **Total liabilities** | | **18,050** | **15,760** |
| | | | |
| **Equity** | | | |
| Called up share capital presented as equity | 23 | 738 | 738 |
| Share premium | 23 | 661 | 661 |
| Reserves | | (6) | (360) |
| **Shareholders' equity** | | **1,393** | **1,039** |
| Other equity instruments | 24 | 200 | 200 |
| **Total equity** | | **1,593** | **1,239** |
| | | | |
| **Total equity and liabilities** | | **19,643** | **16,999** |

The notes on pages 17 to 72 form an integral part of the financial statements.

| **Harry Lorton** | **John O'Beirne** | **Neil Corcoran** | **Hill Wilson** |
|---|---|---|---|
| *Chairman* | *Managing Director* | *Director* | **Secretarial Limited** |

22 February 2019

[1] *Comparative figures have not been restated for the impact of IFRS 9.*

# Statement of changes in equity

for the year ended 31 December 2018

| | Share capital €m | Share premium €m | Retained earnings €m | Cash flow hedge reserve €m | Total shareholders' equity €m | Other equity instruments €m | Total equity €m |
|---|---|---|---|---|---|---|---|
| **At 1 January 2017[1]** | **738** | **661** | **(177)** | **35** | **1,257** | **-** | **1,257** |
| **Comprehensive income** | | | | | | | |
| Loss for the year | - | - | (199) | - | (199) | - | (199) |
| Other comprehensive income | - | - | - | (19) | (19) | - | (19) |
| **Total comprehensive income[1]** | **-** | **-** | **(199)** | **(19)** | **(218)** | **-** | **(218)** |
| **Transactions with owners** | | | | | | | |
| Issue of other equity instruments | - | - | - | - | - | 200 | 200 |
| **At 31 December 2017[1]** | **738** | **661** | **(376)** | **16** | **1,039** | **200** | **1,239** |
| Impact of adopting IFRS 9 at 1 January 2018 (note 2) | - | - | 36 | - | 36 | - | 36 |
| **Restated balance at 1 January 2018** | **738** | **661** | **(340)** | **16** | **1,075** | **200** | **1,275** |
| **Comprehensive income** | | | | | | | |
| Profit for the year | - | - | 301 | - | 301 | - | 301 |
| Other comprehensive income | - | - | - | 17 | 17 | - | 17 |
| **Total comprehensive income** | **-** | **-** | **301** | **17** | **318** | **-** | **318** |
| **At 31 December 2018** | **738** | **661** | **(39)** | **33** | **1,393** | **200** | **1,593** |

The notes on pages 17 to 72 form an integral part of the financial statements.

[1] *Comparative figures have not been restated for the impact of IFRS 9.*

# Notes to the financial statements

| Index | | Page |
|---|---|---|
| 1 | Accounting policies | 18 |
| 2 | Transition from IAS 39 to IFRS 9 | 30 |
| 3 | Interest income calculated using the effective interest method | 30 |
| 4 | Interest expense | 30 |
| 5 | Net trading income / (expense) | 31 |
| 6 | Auditor's remuneration (excluding VAT) | 31 |
| 7 | Operating expenses | 32 |
| 8 | Net impairment gains on financial instruments | 32 |
| 9 | Net loss on derecognition of financial assets measured at amortised cost | 32 |
| 10 | Taxation | 33 |
| 11 | Derivative financial instruments | 33 |
| 12 | Other financial assets at fair value through profit or loss | 36 |
| 13 | Loans and advances to banks | 36 |
| 14 | Loans and advances to customers at amortised cost | 37 |
| 15 | Modified financial assets | 39 |
| 16 | Current tax and deferred tax | 40 |
| 17 | Deposits from banks | 40 |
| 18 | Debt securities in issue | 41 |
| 19 | Other liabilities | 43 |
| 20 | Provisions | 43 |
| 21 | Loss allowance provision on loan commitments | 44 |
| 22 | Subordinated liabilities | 44 |
| 23 | Share capital and share premium | 44 |
| 24 | Other equity instruments | 45 |
| 25 | Pension costs | 45 |
| 26 | Segmental information | 45 |
| 27 | Risk management and control | 45 |
| 28 | Fair values of financial assets and financial liabilities | 62 |
| 29 | Contingent liabilities and commitments | 65 |
| 30 | Related party transactions | 65 |
| 31 | IAS 39 to IFRS 9 transitional disclosures | 69 |
| 32 | Post balance sheet events | 72 |
| 33 | Approval of the financial statements | 72 |

# 1 Accounting policies

Bank of Ireland Mortgage Bank is a public unlimited company, incorporated and domiciled in Ireland. The significant accounting policies adopted by the Bank of Ireland Mortgage Bank (the 'Bank') are as follows:

## 1.1 Basis of preparation

The financial statements comprise the income statement, the statement of comprehensive income, the balance sheet, the statement of changes in equity and the notes to the financial statements on pages 17 to 72.

The financial statements of the Bank have been prepared under the historical cost convention, modified to include the fair valuation of certain financial instruments, in accordance with the Companies Act 2014, the Asset Covered Securities Acts 2001 to 2007 (the 'ACS Acts') and Financial Reporting Standard 101 Reduced Disclosure Framework ('FRS 101').

In preparing these financial statements, the Bank applies the recognition, measurement and disclosure requirements of International Financial Reporting Standards (IFRS) as adopted by the European Union ('Adopted IFRS'), but makes amendments where necessary in order to comply with the Companies Act 2014 and has set out below where advantage of the FRS 101 disclosure exemptions has been taken.

The Bank's ultimate parent company, Bank of Ireland Group plc, is a public limited company incorporated and registered in Ireland. The consolidated financial statements for the Bank of Ireland Group (the 'Group') are available to the public and may be obtained from the Bank of Ireland Head Office, 40 Mespil Road, Dublin 4.

In these financial statements, the Bank has applied the exemptions available under FRS 101 in respect of the following disclosures:

- a cash flow statement and related notes;
- disclosures in respect of transactions with wholly owned subsidiaries of the Group;
- the effects of new but not yet effective IFRS; and
- disclosures in respect of the compensation of key management personnel.

The accounting policies set out below have, unless otherwise stated, been applied consistently to all periods presented in these financial statements. The financial statements have been prepared in euro and are rounded to the nearest million except where otherwise indicated.

## 1.2 Going concern

The time period that the Directors have considered in evaluating the appropriateness of the going concern basis in preparing the financial statements for 2018 is a period of twelve months from the date of approval of these financial statements ('the period of assessment').

In making this assessment, the Directors considered the Bank's business, profit after taxation in 2018, profitability projections, funding and capital plans together with a range of other factors such as the outlook for the Irish economy and the availability of collateral to access the Eurosystem. In addition, the Directors are satisfied that the Bank, through the existence of the Liquidity Management Agreement with its immediate parent company, has sufficient liquidity to meet obligations as they fall due throughout the period of assessment.

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

## 1.3 Comparatives

Comparative figures have been adjusted where necessary, to conform with changes in presentation or where additional analysis has been provided in the current year. Any adjustments to comparatives are disclosed in the relevant note as appropriate.

# 1 Accounting policies (continued)

## 1.4 Adoption of new accounting standards

The Bank's accounting policies have been updated for the application of IFRS 9 from 1 January 2018. The updates together with the accounting policies for the comparative year up to 31 December 2017 are detailed below.

**IFRS 9 'Financial instruments'**
IFRS 9 'Financial instruments' replaces IAS 39 'Financial instruments: recognition and measurement'. It sets out requirements relating to recognition and derecognition, classification, measurement and hedge accounting. IFRS 9 retains but simplifies the mixed measurement model. Financial assets within its scope are required to be classified as being measured, subsequent to initial recognition, at amortised cost, fair value through other comprehensive income or fair value through profit or loss. The classification is dependent on both the overall objective of the business model within which the asset is held and the contractual cash flow characteristics of the asset. Impairment under IFRS 9 is forward-looking and is based on expected rather than incurred losses. For financial liabilities, there is no change to classification and measurement except for recognition of changes in own credit risk in other comprehensive income for certain liabilities designated at fair value through profit or loss. The Bank has made the accounting policy choice allowed under IFRS 9 to continue to apply the hedge accounting requirements of IAS 39.

The financial statements for the comparative year have not been restated to reflect the change with the impact of transition being reflected through equity as at 1 January 2018. Further information is given in notes 2 and 31.

**Presentation**
IFRS 9 amends IAS 1 'Presentation of financial statements' to require certain items to be presented as line items in the income statement, including impairment gains or losses, gains or losses arising from the derecognition of financial assets measured at amortised cost and interest revenue calculated using the effective interest method.

Other than IFRS 9, no other new standards (including IFRS 15), amendments or interpretations, effective for the first time for the financial year beginning on 1 January 2018 have had a material impact on the Bank.

## 1.5 Interest income and expense

Interest income and expense are recognised in the income statement using the effective interest method for financial instruments measured at amortised cost, in accordance with IFRS 9 and previously IAS 39. Interest income and expense from derivative financial instruments designated as hedging instruments are accounted for in net interest income, in line with the underlying hedged asset or liability. Interest in relation to derivatives not designated as a hedging instrument is included in trading income. The effective interest method is the method that is used in the calculation of the amortised cost of a financial asset or liability and in the allocation and recognition of interest revenue or interest expense in profit or loss over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. When calculating the effective interest rate, the Bank estimates the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but does not consider the expected credit losses (except, in accordance with IFRS 9 in the case of purchased or originated credit-impaired financial assets where expected credit losses are included in the calculation of a 'credit adjusted effective interest rate'). The calculation includes all fees, broker commissions, transaction costs, points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

From 1 January 2018, in the case of a financial asset that is neither credit-impaired nor a purchased or originated credit-impaired financial asset, interest revenue is calculated by applying the effective interest rate to the gross carrying amount.

In the case of a financial asset that is not a purchased or originated credit-impaired financial asset but is credit-impaired at the reporting date, interest revenue is calculated by applying the effective interest rate to the amortised cost, which is the gross carrying amount adjusted for any impairment loss allowance.

In the case of a purchased or originated credit-impaired financial asset, interest revenue is recognised by applying the credit-adjusted effective interest rate to the amortised cost.

Where the Bank revises its estimates of payments or receipts on a financial instrument (excluding modifications of a financial asset and changes in expected credit losses under the requirements of IFRS 9), it recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets under IFRS 9). The adjustment is recognised as interest income or expense.

Accrued interest is presented on the balance sheet with the relevant financial asset or liability.

**Modifications**
From 1 January 2018, where the contractual cash flows of a financial asset are modified and the modification does

# 1 Accounting policies (continued)

## 1.5 Interest income and expense (continued)

not result in derecognition of the financial asset, the Bank recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows that are discounted at the financial asset's original effective interest rate and recognises a modification gain or loss in the income statement.

Where a modification is a forbearance measure which does not result in derecognition, the modification gain or loss is included in the income statement within net impairment gains or losses. Otherwise, the modification gain or loss is included within interest income.

Under both IFRS 9 and IAS 39, interest income and expense excludes interest on financial instruments at fair value through profit or loss which is instead included within the fair value movements recognised within net trading income.

## 1.6 Fee and commission income

Fees and commissions which are not an integral part of the effective interest rate of a financial instrument are generally recognised as the related services are provided.

## 1.7 Financial assets

1. **Recognition, classification and measurement**
From 1 January 2018, the Bank applies the following accounting policies to the classification, recognition and measurement policies to financial assets.

A financial asset is recognised in the balance sheet when, and only when, the Bank becomes a party to its contractual provisions. At initial recognition, a financial asset is measured at fair value (plus, in the case of a financial asset not at fair value through profit or loss, directly attributable transaction costs) and is assigned one of the following classifications for the purposes of subsequent measurement:
- financial assets at amortised cost;
- financial assets at fair value through other comprehensive income; or
- financial assets at fair value through profit or loss.

The Bank determines the appropriate classification based on the contractual cash flow characteristics of the financial asset and the objective of the business model within which the financial asset is held. In determining the business model for a group of financial assets, the Bank considers factors such as how performance is evaluated and reported to key management personnel; the risks that affect performance and how they are managed; how managers are compensated; and the expected frequency, value and timing of sales of financial assets.

In considering the contractual cash flow characteristics of a financial asset, the Bank determines whether the contractual terms give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding. In this context, 'principal' is the fair value of the financial asset on initial recognition and 'interest' is consideration for the time value of money and for the credit risk associated with the principal amount outstanding during a particular period of time and for other basic lending risks and costs (e.g. liquidity risk and administrative costs), as well as profit margin. In making the determination, the Bank assesses whether the financial asset contains a contractual term that could change the timing or amount of contractual cash flows such that it would not meet this condition. In making this assessment, the Bank considers contingent events, leverage features, prepayment and term extensions, terms which limit the Bank's recourse to specific assets and features that modify consideration of the time value of money.

(a) **Financial assets at amortised cost.**
*Debt instruments*
A debt instrument is measured, subsequent to initial recognition, at amortised cost where it meets both of the following conditions and has not been designated as measured at fair value through profit or loss:
- the financial asset has contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding; and
- the financial asset is held within a business model whose objective is achieved by holding financial assets to collect contractual cash flows.

Purchases and sales of debt securities at amortised cost are recognised on trade date: the date on which the Bank commits to purchase or sell the asset. Loans measured at amortised cost are recognised when cash is advanced to the borrowers.

Interest revenue using the effective interest method is recognised in the income statement. An impairment loss allowance is recognised for expected credit losses with corresponding impairment gains or losses recognised in the income statement.

(b) **Financial assets at fair value through other comprehensive income**
*Debt instruments*
A debt instrument is measured, subsequent to initial recognition,

# 1 Accounting policies (continued)

## 1.7 Financial assets (continued)

at fair value through other comprehensive income where it meets both of the following conditions and has not been designated as measured at fair value through profit or loss:

- the financial asset has contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding; and
- the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets.

***Equity instruments***
Where an irrevocable election has been made by the Bank at initial recognition, an investment in an equity instrument that is neither 'held for trading' nor contingent consideration recognised by the Bank in a business combination to which IFRS 3 'Business combinations' applies, is measured at fair value through other comprehensive income. Amounts presented in other comprehensive income are not subsequently transferred to profit or loss. Dividends on such investments are recognised in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment. Regular way purchases and sales of financial assets measured at fair value through other comprehensive income are recognised on trade date.

These classifications are not in use by the Bank.

**(c) Financial assets at fair value through profit or loss**
All other financial assets are measured, subsequent to initial recognition, at fair value through profit or loss. Financial assets at fair value through profit or loss comprise:

***Financial assets mandatorily measured at fair value through profit or loss***
Financial assets meeting either of the conditions below are mandatorily measured at fair value through profit or loss (other than in respect of an equity investment designated as at fair value through other comprehensive income):

- financial assets with contractual terms that do not give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding; and
- financial assets held within a business model whose objective is achieved neither by collecting contractual cash flows nor both collecting contractual cash flows and selling financial assets. This classification includes the Bank's portfolio of Life Loans.

***Financial assets designated as measured at fair value through profit or loss***
A financial asset may be designated at fair value through profit or loss only if doing so eliminates or significantly reduces measurement or recognition inconsistencies (an 'accounting mismatch') that would otherwise arise from measuring financial assets or liabilities or recognising gains and losses on them on different bases.

Regular way purchases and sales of financial assets at fair value through profit or loss are recognised on trade date. They are carried on the balance sheet at fair value, with all changes in fair value included in the income statement.

**2. Reclassification**
From 1 January 2018, when, and only when, the Bank changes its business model for managing financial assets, it reclassifies all affected financial assets. Reclassification is applied prospectively from the reclassification date, which is the first day of the first reporting period following the change in business model that results in the reclassification. Any previously recognised gains, losses or interest are not restated.

**3. Derecognition**
A financial asset is derecognised when the contractual rights to the cash flows from the financial asset expire or the Bank has transferred substantially all the risks and rewards of ownership. Where a modification results in a substantial change to the contractual cash flows of a financial asset, it may be considered to represent expiry of the contractual cash flows, resulting in derecognition of the original financial asset and recognition of a new financial asset at fair value. The Bank reduces the gross carrying amount of a financial asset and the associated impairment loss allowance when it has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof.

**Until 31 December 2017, under the requirements of IAS 39, the Bank categorised its financial assets as: financial assets at fair value through profit or loss and loans and receivables, and determined the classification of its financial assets at initial recognition. The Bank's policies for the classification, recognition and measurement of financial assets under IAS 39 were as follows:**

***(a) Financial assets at fair value through profit or loss***
Financial assets at fair value through profit or loss could either be held for trading, if acquired principally for the purpose of selling in the short term, or designated at fair value through profit or loss at inception.

***(b) Loans and receivables***
Loans and receivables were non-derivative financial assets with fixed or determinable payments that were not quoted in an active market. Loans were recorded at fair value plus transaction costs when cash was

# 1 Accounting policies (continued)

## 1.7 Financial assets (continued)

advanced to the borrowers. They were subsequently accounted for at amortised cost using the effective interest method.

*(c) Derecognition*
Financial assets were derecognised when the rights to receive cash flows from the financial assets had expired or where the Bank had transferred substantially all risks and rewards of ownership.

## 1.8 Impairment of financial instruments

**Scope**
From 1 January 2018, the Bank recognises impairment loss allowances for expected credit losses (ECL) on the following categories of financial instruments unless measured at fair value through profit or loss:
- financial assets that are debt instruments; and
- loan commitments.

**Basis for measuring impairment**
The Bank allocates financial instruments into the following categories at each reporting date to determine the appropriate accounting treatment.

*Stage 1: 12-month ECL (not credit-impaired)*
These are financial instruments where there has not been a significant increase in credit risk since initial recognition. An impairment loss allowance equal to 12-month ECL is recognised. This is the portion of lifetime ECL resulting from default events that are possible within the next 12 months.

*Stage 2: Lifetime ECL (not credit-impaired)*
These are financial instruments where there has been a significant increase in credit risk since initial recognition but which are not credit-impaired. An impairment loss allowance equal to lifetime ECL is recognised. Lifetime ECL are the ECL resulting from all possible default events over the expected life of the financial instrument.

*Stage 3: Lifetime ECL (credit-impaired)*
These are financial instruments which are credit-impaired at the reporting date but were not credit-impaired at initial recognition. An impairment loss allowance equal to lifetime ECL is recognised.

*Purchased or originated credit-impaired financial assets*
These are financial assets that were credit-impaired at initial recognition. They are not subject to any initial impairment loss allowance but an impairment loss allowance is subsequently recognised for the cumulative changes in lifetime ECL since initial recognition. A purchased or originated credit-impaired financial asset remains classified as such until it is derecognised, even if assessed as no longer credit-impaired at a subsequent reporting date.

With the exception of purchased or originated credit-impaired financial assets, a financial instrument may migrate between stages from one reporting date to the next.

**Significant increase in credit risk**
In determining if a financial instrument has experienced a significant increase in credit risk since initial recognition, the Bank assesses whether the risk of default over the remaining expected life of the financial instrument is significantly higher than had been anticipated at initial recognition, taking into account changes in prepayment expectations where relevant. The Bank uses reasonable and supportable information available without undue cost or effort at the reporting date, including forward-looking information. A combination of quantitative, qualitative and backstop indicators are generally applied in making the determination. For certain portfolios, the Bank assumes that no significant increase in credit risk has occurred if credit risk is 'low' at the reporting date.

**Credit-impaired**
A financial asset is credit-impaired when one or more events that have a detrimental impact on the estimated future cash flows have occurred. Evidence that a financial asset is credit-impaired includes observable data about the following events:
(a) significant financial difficulty of the issuer or the borrower;
(b) a breach of contract, such as a default or past due event;
(c) the lender(s) of the borrower, for economic or contractual reasons relating to the borrower's financial difficulty, having granted to the borrower a concession(s) that the lender(s) would not otherwise consider;
(d) it is becoming probable that the borrower will enter bankruptcy or other financial reorganisation; or
(e) the purchase or origination of a financial asset at a deep discount that reflects the incurred credit losses.

It may not be possible to identify a single discrete event - instead, the combined effect of several events may have caused financial assets to become credit-impaired.

**Measurement of ECL and presentation of impairment loss allowances**
ECL are measured in a way that reflects:
(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
(b) the time value of money; and
(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

ECL are measured as follows:
- financial assets that are not credit-impaired at the reporting date: the present value of the difference between all contractual cash flows due to the Bank in accordance with the contract and all the cash flows the Bank expects to receive;
- financial assets that are credit-impaired at the reporting date: the difference between the gross carrying amount and the present value of estimated future cash flows; and
- undrawn loan commitments: the present value difference between the contractual cash flows that are due to the Bank if the commitment is drawn and the cash flows that the Bank expects to receive.

For financial assets, the discount rate used in measuring ECL is the effective

# 1 Accounting policies (continued)

## 1.8 Impairment of financial instruments (continued)

interest rate (or 'credit-adjusted effective interest rate' for a purchased or originated credit-impaired financial asset) or an approximation thereof. For undrawn loan commitments, it is the effective interest rate, or an approximation thereof, that will be applied when recognising the financial asset resulting from the loan commitment.

Impairment loss allowances for ECL are presented in the financial statements as follows:

- financial assets at amortised cost: as a deduction from the gross carrying amount in the balance sheet; and
- loan commitments: as a provision in the balance sheet.

**Utilisation of impairment loss allowances**

The Bank reduces the gross carrying amount of a financial asset and the associated impairment loss allowance when it has no reasonable expectations of recovering a financial asset in its entirety or a portion thereof. Indicators that there is no reasonable expectation of recovery include the collection process having been exhausted or it becoming clear during the collection process that recovery will fall short of the amount due to the Bank. The Bank considers, on a case-by-case basis, whether enforcement action in respect of an amount that has been written off from an accounting perspective is or remains appropriate. Any subsequent recoveries are included in the income statement as an impairment gain.

**Forbearance**

Forbearance occurs when a borrower is granted an agreed change to a loan ('forbearance measure') for reasons relating to the actual or apparent financial stress or distress of that borrower. Forbearance has not occurred if the agreed change to a loan granted to a borrower is not related to the actual or apparent financial stress or distress of that borrower.

Prior to any decision to grant forbearance, the Bank performs an assessment of a customer's financial circumstances and ability to repay and assesses whether the loan is credit-impaired. Where the loan is credit-impaired, it is allocated to stage 3 (unless a purchased or credit-impaired financial asset). If a forborne loan has a variable interest rate, the discount rate for measuring ECL is the current effective interest rate determined under the contract before the modification of terms. Financial assets to which forbearance has been applied continue to be reported as forborne until such time as they satisfy conditions to exit forbearance in line with EBA guidance on non-performing and forborne classifications. Forborne financial assets which are not credit-impaired are generally allocated to stage 2. Where the cash flows from a forborne loan are considered to have expired, the original financial asset is derecognised and a new financial asset is recognised, initially measured at fair value. Any difference between the carrying value of the original financial asset and the fair value of the new financial asset on initial recognition is recognised in the income statement. The new financial asset may be initially allocated to stage 1 or, if credit- impaired, be categorised as a purchased or originated credit-impaired financial asset. Where a forbearance measure represents a modification of the contractual cash flows of a financial asset and does not result in its derecognition, the Bank recalculates the gross carrying amount of the financial asset as the present value of the modified contractual cash flows that are discounted at the financial asset's original effective interest rate (before any modification of terms) and a modification gain or loss is included in the income statement within net impairment gains or losses.

**Until 31 December 2017, under the requirements of IAS 39, the Bank recognised impairment of financial instruments as follows:**

**Assets carried at amortised cost**

The Bank assessed at each reporting date whether there was objective evidence that a financial asset or group of financial assets was impaired. A financial asset or a group of financial assets was impaired and impairment losses were incurred if, and only if, there was objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) had an impact on the estimated future cash flows of the financial asset or group of financial assets that could be reliably estimated.

Objective evidence that a financial asset or group of assets was impaired included observable data that came to the attention of the Bank about the following loss events:

(a) delinquency in contractual payments of principal or interest;
(b) cash flow difficulties;
(c) breach of loan covenants or conditions;
(d) deterioration of the borrower's competitive position;
(e) deterioration in the value of collateral;
(f) initiation of bankruptcy proceedings; and
(g) granting a concession to a borrower, for economic or legal reasons relating to the borrower's financial difficulty that would otherwise not be considered.

The Bank first assessed whether objective evidence of impairment existed individually for financial assets that were individually significant, and individually or collectively for financial assets that were not individually significant. If the Bank determined that no objective evidence of impairment existed for an individually assessed financial asset, whether significant or not, it included the asset in a group of financial assets with similar credit risk characteristics and collectively assessed them for impairment. Assets that were individually assessed for impairment and for which an impairment loss was recognised were not included in a collective assessment of impairment. If there was objective evidence that an impairment loss on loans and advances had been incurred, the amount of the loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that had not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset was reduced through the use of an allowance account and the amount of the loss was recognised in the income statement. If a loan had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate determined under the contract.

The calculation of the present value of the estimated future cash flows of a collateralised financial asset reflected the cash flows that may have resulted from foreclosure less the cost of obtaining and selling the collateral, whether or not foreclosure was probable.

# 1 Accounting policies (continued)

## 1.8 Impairment of financial instruments (continued)

For the purposes of a collective evaluation of impairment, financial assets were grouped on the basis of similar credit risk characteristics (i.e. on the basis of the Bank's grading process that considered asset type, geographical location, collateral type, past-due status and other relevant factors). Those characteristics were relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' 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 were collectively evaluated for impairment were 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 was 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 was based and to remove the effects of conditions in the historical period that did not exist currently. The methodology and assumptions used for estimating future cash flows were reviewed regularly by the Bank to reduce any differences between loss estimates and actual loss experience.

If, in a subsequent period, the amount of the impairment loss decreased and the decrease could be related objectively to an event occurring after the impairment was recognised, the previously recognised impairment loss was reversed by adjusting the allowance account. The amount of the reversal was recognised in the income statement.

When a loan was deemed uncollectible, it was derecognised and the provision for impairment was utilised. Subsequent recoveries decreased the amount of the charge for loan impairment in the income statement.

**Forbearance**
Forbearance occurred when a borrower was granted an agreed change to the contractual terms of a mortgage loan ('forbearance measure') for reasons relating to the actual or apparent financial stress or distress of that borrower. Forbearance had not occurred if the agreed change to a mortgage loan granted to a borrower was not related to the actual or apparent financial stress or distress of that borrower.

Prior to any decision to grant forbearance, the Bank performed an assessment of a customer's financial circumstances and ability to repay. This assessment included an individual assessment for impairment of the mortgage loan. If the Bank determined that no objective evidence of impairment existed for an individually assessed forborne asset, whether significant or not, it included the loan in a group of loans with similar credit risk characteristics and collectively assessed them for impairment.

Where the forborne loan was considered to be impaired, the amount of the loss was measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that had not been incurred) discounted at the asset's original effective interest rate before the modification of terms. The carrying amount of the asset was reduced through the use of an allowance account and the amount of the loss was recognised in the income statement. If a forborne asset had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate determined under the contract before the modification of terms.

Assets to which forbearance had been applied continued to be reported as forborne until such time as they satisfied conditions to exit forbearance in line with European Banking Authority (EBA) guidance on non-performing and forborne classifications.

Where the cash flows from a forborne loan were considered to have expired, the original asset was derecognised and a new asset was recognised, initially measured at fair value. Any difference between the carrying value of the original asset and the fair value of the new asset on initial recognition was recognised in the income statement. Interest accrued on the new asset based on the current market rates in place at the time of the renegotiation.

**Non-forbearance renegotiation**
Where an agreed change to a loan was not directly linked to apparent financial stress or distress, these amendments were not considered forbearance. Any changes in expected cash flows were accounted for under IAS 39. If a renegotiated asset had a variable interest rate, the discount rate for measuring any impairment loss was the current effective interest rate determined under the contract. However, where cash flows on the original asset had been considered to have expired, the original asset was derecognised and a new asset was recognised at fair value. Any difference arising between the derecognised asset and the new asset was recognised in the income statement.

# 1 Accounting policies (continued)

## 1.9 Financial liabilities

Under both IFRS 9 and IAS 39, the Bank classifies its financial liabilities as being measured at amortised cost unless it has designated liabilities at fair value through profit or loss or is required to measure liabilities mandatorily at fair value through profit or loss such as derivative liabilities. Financial liabilities are initially recognised at fair value, (normally the issue proceeds i.e. the fair value of consideration received) less, in the case of financial liabilities subsequently carried at amortised cost, transaction costs. For financial liabilities carried at amortised cost, any difference between the proceeds, net of transaction costs, and the redemption value is recognised in the income statement using the effective interest method.

When a financial liability that is measured at amortised cost is modified without resulting in derecognition, a gain or loss should be recognised in profit or loss. The gain or loss is calculated as the difference between the original contractual cash flows and the modified contractual cash flows discounted at the original effective interest rate.

Financial liabilities are derecognised when they are extinguished, that is when the obligation is discharged, cancelled or expires.

## 1.10 Offsetting

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is currently a legally enforceable right of set off and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously. Under IFRS 9, no impairment loss allowance for expected credit losses is recognised on a financial asset, or portion thereof, which has been offset.

## 1.11 Valuation of financial instruments

The Bank recognises certain financial assets and financial liabilities (including derivative financial instruments) at fair value in the balance sheet. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date in the principal, or in its absence, the most advantageous market to which the Bank has access at that date. If an active market does not exist, the Bank establishes fair value using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow (DCF) analysis, option pricing models and other valuation techniques commonly used by market participants. To the extent possible, these valuation techniques use observable market data. Where observable data does not exist, the Bank uses estimates based on the best information available.

The best evidence of the fair value of a financial instrument at initial recognition is the transaction price in an arm's length transaction, unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e. without modification or repackaging) or based on a valuation technique which uses only observable market inputs. When such evidence exists, the initial valuation of the instrument may result in the Bank recognising a profit on initial recognition. In the absence of such evidence, the instrument is initially valued at the transaction price. Any day one profit is deferred and recognised in the income statement to the extent that it arises from a change in a factor that market participants would consider in setting a price. Straight line amortisation is used where it approximates to that amount.

Subsequent changes in fair value are recognised immediately in the income statement without the reversal of deferred day one profits or losses. Where a transaction price in an arm's length transaction is not available, the fair value of the instrument at initial recognition is measured using a valuation technique.

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

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

# 1 Accounting policies (continued)

## 1.12 Derivative financial instruments and hedge accounting

The Bank has made the accounting policy choice allowed under IFRS 9 to continue to apply the hedge accounting requirements of IAS 39.

Derivatives are initially recognised at fair value on the date on which the contract is entered into and are subsequently remeasured at their fair value at each reporting date. All derivatives are carried as assets when their fair value is positive and as liabilities when their fair value is negative.

Certain derivatives embedded in other financial instruments that are not financial assets are separated from the host contract and accounted for as derivatives, when their economic characteristics and risks are not closely related to those of the host contract and the entire host contract is not carried at fair value through profit or loss.

Fair value gains or losses on derivatives are normally recognised in the income statement. However where they are designated as hedging instruments, the treatment of the fair value gains and losses depends on the nature of the hedging relationship.

The Bank designates certain derivatives as either:

(i) hedges of the exposure to changes in the fair value of recognised assets or liabilities that is attributable to a particular risk (fair value hedge); or
(ii) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedge).

Hedge accounting is applied to these derivatives provided certain criteria are met. The Bank documents, at the inception of the transaction, the relationship between hedging instruments and hedged items, as well as its risk management objective and strategy for undertaking various hedge transactions.

The Bank also documents its assessment, both at hedge inception and on an ongoing basis, of whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Hedge relationships are concluded to be effective if the hedging instruments that are used in hedging transactions offset the changes in fair value or cash flow of the hedged items within a range of 80% to 125%. Where a hedging instrument is novated to a clearing counterparty, the Bank does not discontinue hedge accounting where the following criteria are met:

- the novation arises due to laws or regulations, or the introduction of laws and regulations;
- the parties to the hedging instrument agree that one or more clearing counterparties replace their original counterparty to become the new counterparty to each of the parties; and
- the novation does not result in changes to the terms of the original instrument except for those changes necessary to effect the change in counterparty.

**(a) Fair value hedge**

Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the income statement, together with any changes in the fair value of the hedged asset or liability that are attributable to the hedged risk.

The hedged item in a micro fair value hedge is a single specified item e.g. a fixed rate loan. If the criteria for hedge accounting cease to be met, no further adjustments are made to the hedged item for fair value changes attributable to the hedged risk. The cumulative adjustment to the carrying amount of a hedged item is amortised to profit or loss over the period to maturity using the effective interest method.

The hedged item in a macro fair value hedge is a pool of assets or liabilities with similar risk characteristics and profiles, such as a pool of fixed rate mortgages.

Unlike micro fair value hedge accounting, macro fair value hedge accounting is not discontinued if an individual asset or liability within the pool of hedged items is sold, so long as the overall pool of hedged items retains its characteristics as documented at inception of the hedge. In addition, hedge effectiveness testing is performed on a portfolio basis rather than on an individual hedge relationship by hedge relationship basis.

If the criteria for hedge accounting cease to be met, no further adjustments are made to the hedged item for fair value changes attributable to the hedged risk. The cumulative adjustment to the carrying amount of a hedged item is amortised to profit or loss over the period to maturity using the effective interest method.

**(b) Cash flow hedge**

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges is recognised in other comprehensive income. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in other comprehensive income are reclassified to the income statement in the periods in which the hedged item affects profit or loss.

When a hedging instrument expires or is sold, or when a hedge no longer meets the criteria for hedge accounting, any cumulative gain or loss existing in other comprehensive income at that time remains in other comprehensive income and is recognised in the income statement when the forecast transaction occurs. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in other comprehensive income is immediately reclassified to the income statement.

# 1 Accounting policies (continued)

## 1.13 Issued debt and equity securities

The classification of instruments as a financial liability or equity instrument is dependent upon the substance of the contractual arrangement. Instruments which carry a contractual obligation to deliver cash or another financial asset to another entity are classified as financial liabilities. The coupons on these instruments are recognised in the income statement as interest expense using the effective interest method. Where the Bank has absolute discretion in relation to the repayment of the coupons and repayment of principal, the instrument is classified as equity and any coupon payments are classified as distributions in the period in which they are made.

If the Bank purchases its own debt it is removed from the balance sheet and the difference between the carrying amount of the liability and the consideration paid, is included in net trading income, net of any costs or fees incurred.

## 1.14 Income taxes

**(a) Current income tax**
Income tax payable on profits, based on applicable tax law, is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for utilisation by other Group companies are recognised as an asset when it is probable that taxable group profits will be available against which these losses can be utilised in the year.

**(b) Deferred income tax**
Deferred income tax is provided in full, using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred income tax is determined using tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled. Deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss.

Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences due to unused tax losses can be utilised. Deferred tax assets and liabilities are not discounted.

Deferred tax on items taken to other comprehensive income is also recognised in other comprehensive income and is subsequently reclassified to the income statement together with the deferred gain or loss. Income tax on items recognised directly in equity is recognised directly in equity.

## 1.15 Pensions

The Group operates various pension schemes, certain of which employees of the Bank are members: ICS Building Society Pension Plan (the ‘ICS PP’) and Bank of Ireland Group Pensions Fund (BIGPF). The ICS PP is a defined benefit scheme. A defined benefit scheme is a pension plan that defines the amount of the pension to be provided, usually a function of one or more factors such as age, years of service or compensation.

The BIGPF is a hybrid scheme which includes elements of both defined benefit and defined contribution arrangements. Under IAS 19 the BIGPF is accounted for as a defined benefit scheme.

The schemes are operated for eligible employees of Bank of Ireland (the ‘Principal Employer’) and certain of its subsidiaries, including the Bank, which are entities under common control. While the schemes are recognised as defined benefit schemes, the Principal Employer recognises the net defined benefit cost of the plan as a whole and the Bank recognises a cost equal to its contributions payable for the year.

Further information on the Group’s pension schemes is available in note 47 of the Group’s Annual Report for the year ended 31 December 2018.

## 1.16 Share capital and reserves

**(a) Dividends on ordinary shares**
Final dividends on ordinary shares are recognised in equity in the period in which they are approved by the Bank’s shareholders on the recommendation of the Board of Directors, or approved by the Board of Directors, as appropriate. Interim dividends are recognised in equity in the period in which they are paid.

**(b) Cash flow hedge reserve**
The cash flow hedge reserve represents the cumulative changes in fair value, excluding any ineffectiveness, of cash flow hedging derivatives. These are transferred to the income statement when the hedged transactions impact the Bank’s profit or loss.

**(c) Other equity instruments**
Other equity instruments represent the issuance of Additional tier 1 notes by the Bank to its immediate parent. See note 24 for details.

# 1 Accounting policies (continued)

## 1.17 Collateral

The Bank enters into master 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.

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

The Bank also receives collateral in the form of cash or securities in respect of other credit instruments, such as stock borrowing contracts and derivative contracts, in order to reduce credit risk. Collateral received in the form of securities is not recorded on the balance sheet. Collateral received in the form of cash is recorded on the balance sheet, with a corresponding liability recognised within deposits from banks or deposits from customers. Any interest payable arising is recorded as interest expense.

In certain circumstances, the Bank pledges collateral in respect of liabilities or borrowings. Collateral pledged in the form of securities or loans and advances continues to be recorded on the balance sheet. Collateral placed in the form of cash is recorded in loans and advances to banks or customers. Any interest receivable arising is recorded as interest income.

## 1.18 Provisions

Provisions are recognised when the Bank has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate of the amount of the obligation can be made.

Contingent liabilities are not recognised but are disclosed unless the probability of their occurrence is remote.

## 1.19 Critical accounting estimates and judgements

In preparing the financial statements, the Bank makes estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses. Estimates and judgements are continually evaluated and are based on historical experience and other factors, including expectations of future events that are believed to be reasonable under the circumstances. As management judgement involves an estimate of the likelihood of future events, actual results could differ from those estimates, which could affect the future reported amounts of assets and liabilities. The estimates and judgements that have had the most significant effect on the amounts recognised in the Bank's financial statements are set out below.

**(a) Impairment charges on financial assets**

The measurement of impairment loss allowance requires significant judgement and is dependent in large part on complex impairment models. In arriving at impairment loss allowances, accounting judgements and estimates which could have a material influence on the quantum of impairment loss allowance and net impairment charge include:

- the Bank's criteria for assessing if there has been a significant increase in credit risk since initial recognition such that a loss allowance for lifetime rather than 12 month ECL is required;
- generation of forward-looking macroeconomic scenarios and their probability weightings which are used in both the assessment of 'significant increase in credit risk' and in the measurement of impairment loss allowances;
- selection of the most relevant macroeconomic variables for particular portfolios and determining associations between those variables and model components such as Probability of Default (PD) and Loss Given Default (LGD);
- the selection of appropriate methodologies and model factors for internal risk rating and impairment models;
- valuing collateral and determining timeframe to realisation and likely net sale proceeds;
- the approximation made at transition to IFRS 9 of the residual lifetime PD expectations for most exposures originated prior to adoption of IFRS 9; and
- determining what Bank management adjustments may be necessary to impairment model outputs to address impairment model limitations or late breaking events.

The Bank's approach to measurement of impairment loss allowances and associated methodologies, including the key macroeconomic variables applied at 31 December 2018, is set out in the credit risk methodologies section on pages 49 to 51.

The quantum of impairment loss allowance is impacted by the application of three probability weighted future macroeconomic scenarios. Table 1 on the next page indicates the approximate extent to which the impairment loss allowance at 31 December 2018 was increased by virtue of applying multiple scenarios rather than just a central scenario.

# 1 Accounting policies (continued)

## 1.19 Critical accounting estimates and judgements (continued)

Table 2 indicates the approximate extent to which the impairment loss allowance, excluding management adjustments, would be higher or lower than reported were a 100% weighting applied to the upside and downside future macroeconomic scenarios respectively.

At 31 December 2018, the impairment loss allowance of €324 million includes a management adjustment of €50 million. This represents consideration of factors including the evolving nature of impairment modelling under IFRS 9 and measurement uncertainty. The corresponding adjustment on transition to IFRS 9 on 1 January 2018 was €100 million, with the reduction to €50 million reflecting model refinements and parameter updates applied at 31 December 2018 which resulted in a portion of the opening adjustment being embedded in the impairment model outputs.

| Table: 1 | Additional impairment loss allowance | | Additional impairment loss allowance on stage 1 and 2 financial instruments | |
|---|---|---|---|---|
| | Impact €m | Impact % | Impact €m | Impact % |
| **Total** | **5** | **1.5%** | **2** | **20%** |

| Table: 2 | Impact of applying a 100% weighting to the upside scenario | | Impact of applying a 100% weighting to the downside scenario | |
|---|---|---|---|---|
| | €m | % | €m | % |
| **Total** | **(76)** | **(23%)** | **90** | **28%** |

**(b) Effective interest method**

The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability and of allocating the interest income or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument but does not consider future credit losses. The calculation includes all fees, broker commissions, transaction costs, points paid or received between parties to the contract and all other premia or discounts that are an integral part of the effective interest rate.

In determining the effective interest rate, management exercises judgement on such matters as the expected life, expected cash flows and the appropriateness of how the cash flows are spread over the expected life. As part of this review, economic factors such as unemployment levels, consumer confidence and economic and fiscal stability were considered, along with mortgage market specific factors such as house price levels, switcher activity and consumer demand. It is estimated that a one year move in the expected life would have an impact of c.€26.5 million in the income statement. There has been no change to the average life assumption in 2018.

**(c) Tracker Mortgage Examination Review**

At 31 December 2018, the Bank has recognised a provision of €38 million (2017: €123 million) in connection with the Bank's tracker mortgage examination. The provision represents the Bank's best estimate of the redress and compensation to be paid to impacted customers and the costs to be incurred by the Bank in connection with the examination.

The CBI examination is still ongoing. There are still a number of uncertainties as to the eventual total cost of the examination. Management has therefore exercised judgement to determine appropriate provision assumptions which include estimates of the level of appeals, appeal success rates and the level of costs to be incurred by the Bank in concluding the examination.

Given the uncertainties outlined above, it is possible that the eventual outcome may differ from the current estimate with a corresponding impact on profit or loss in future periods.

**(d) Life Loans**

The measurement of fair value of financial assets requires significant judgement and the estimation of fair value is achieved using the discounted cash flow analysis technique. Under this approach, estimated future cash flows and discount rates are based on current market information alongside credit quality and maturity characteristics.

In arriving at the fair value, through the determination of the underlying cash flows, management exercises judgement on such matters as:

- selection of the most relevant market information to support the discount rate spread;
- valuation of collateral, determining the timeframe to realisation and likely net sale proceeds; and
- determining what Bank management adjustments may be necessary to address model limitations or late breaking events.

The most sensitive of the model inputs is the discount rate applied as part of the cash flow analysis. It is estimated that a movement of 50 basis points in this discount rate would have an impact of €11 million in the income statement.

## 2 Transition from IAS 39 to IFRS 9

As set out in the basis of preparation and accounting policies, the financial information has been prepared in accordance with IFRS 9 as endorsed by the EU. The Bank has availed of the exemption in paragraph 7.2.15 of IFRS 9 from restating prior periods in respect of the classification and measurement requirements of IFRS 9. Accordingly, differences in the carrying amount of financial instruments arising from the adoption of IFRS 9 are recognised in equity as at 1 January 2018.

A description of the IFRS 9 accounting policies is set out in pages 18 to 29 of these financial statements. A reconciliation of the balance sheet classification as at 1 January 2018 under IAS 39 to the classification under IFRS 9 is included in note 31 (separately identifying by measurement category the changes in the carrying amount arising from reclassification and measurement on transition to IFRS 9). In addition, a reconciliation of the closing impairment provision under IAS 39 and provision under IAS 37 at 31 December 2017 to the opening loss allowance at 1 January 2018 determined in accordance with IFRS 9 is included on page 38.

| | **Shareholders' equity €m** |
|---|---|
| As reported under IAS 39 / 37 as at 31 December 2017 | 1,039 |
| Impact of remeasurement (after tax) | 36 |
| **As reported under IFRS 9 at 1 January 2018** | **1,075** |

The table above sets out the summary reconciliation from the previously reported shareholders' equity for 31 December 2017 under IAS 39 to shareholders' equity at 1 January 2018 following the adoption of IFRS 9.

## 3 Interest income calculated using the effective interest method

There was no further charge in 2018 (2017: €74 million) in respect of redress under the Tracker Mortgage Examination Review. However, there was a reallocation of €11 million charged to interest income from operating expenses during the year (see note 7).

In 2018, €26.6 million of interest was recognised on credit impaired loans and advances to customers at the year end. In 2017, €18.4 million of interest income was recognised on impaired loans and advances to customers on which a specific impairment provision had been recognised at the year end.

| | **2018 €m** | 2017 €m |
|---|---|---|
| Loans and advances to banks | 18 | 17 |
| Loans and advances to customers at amortised cost[1] | 417 | 488 |
| **Underlying interest income on financial assets measured at amortised cost[2]** | **435** | **505** |
| Impact of Tracker Mortgage Examination Review | (11) | (74) |
| **Total interest income calculated at the effective interest method** | **424** | **431** |
| Of which receivable from Bank of Ireland (including swap interest) | 33 | 39 |

In 2018, €20.9 million of interest income was received on credit impaired loans and advances to customers at the year end. In 2017, €9.3 million of interest income was received on impaired loans and advances to customers on which a specific impairment provision had been recognised at the year end.

## 4 Interest expense

| | **2018 €m** | 2017 €m |
|---|---|---|
| Debt securities in issue | 73 | 85 |
| Other interest payable | 45 | 104 |
| Interest on subordinated liabilities | 4 | 11 |
| **Interest expense from financial liabilities measured at amortised cost** | **122** | **200** |
| Of which payable to Bank of Ireland | 50 | 115 |

[1] *Interest income on loans and advances to customers at amortised cost has not been restated for 2017. Interest income on Life Loans was included in interest income in 2017 and is part of net trading income (note 5) in 2018.*

[2] *Underlying net interest income is net interest income excluding the impact of the Tracker Mortgage Examination Review and comprises underlying interest income of €435 million (2017: €505 million) less interest expense €122 million (see note 4) (2017: €200 million).*

## 5 Net trading income / (expense)

In 2018, net trading income was €22 million (2017: €3 million expense) which principally includes fair value movements, including interest received on Life Loans.

Net income from other financial assets mandatorily measured at fair value through profit or loss includes interest income from Life Loans and realised and unrealised gains and losses.

Comparative figures have not been restated for the impact of IFRS 9.

Interest rate contracts include interest and fair value movements on derivative contracts that do not qualify for hedge accounting, including those that were originally in a fair value hedge relationship which no longer qualify for hedge accounting.

| | **2018 €m** | 2017 €m |
|---|---|---|
| Net income from other financial assets mandatorily measured at fair value through profit or loss | 15 | - |
| Purchase of own debt | - | (2) |
| Interest rate contracts | 7 | (1) |
| | **22** | **(3)** |
| **Fair value hedges** | | |
| Fair value gain on liabilities in fair value hedge relationships | 2 | 4 |
| Fair value loss on derivative contracts in fair value hedge relationships | (2) | (4) |
| | **-** | **-** |
| **Net trading income / (expense)** | **22** | **(3)** |

## 6 Auditor's remuneration (excluding VAT)

On 16 July 2018, PricewaterhouseCoopers of One Spencer Dock, North Wall Quay, Dublin 1 (former Auditor), resigned as Auditor of the Bank, and on 17 July 2018, KPMG of 1 Harbourmaster Place, IFSC, Dublin 1 (current Auditor) was appointed.

Disclosure of Auditor's fees is made in accordance with Section 322 of the Companies Act, 2014 which mandates the disclosure of fees in particular categories and that fees paid to the Bank Auditor only (KPMG) for services provided to the Bank be disclosed in this format. All years presented are on that basis.

The amounts in the first table relate to fees payable to KPMG from the date of appointment for services provided:

(i) fees paid to the Statutory Auditor, KPMG; and
(ii) assurance services consist primarily of fees in connection with letters of comfort, on the issuance of asset covered securities.

The amounts in the second table above relate to fees payable to PricewaterhouseCoopers (former Auditor) up to the date of their resignation.

| **Current Auditor** | **2018 €'000** | 2017 €'000 |
|---|---|---|
| **Audit and assurance services** | | |
| Statutory audit | 45 | - |
| Assurance services | 25 | - |
| | **70** | **-** |
| **Other services** | | |
| Taxation services | - | - |
| Other non-audit services | - | - |
| **Total auditor's remuneration** | **70** | **-** |

| **Former Auditor** | **2018 €'000** | 2017 €'000 |
|---|---|---|
| **Audit and assurance services** | | |
| Statutory audit | - | 48 |
| Assurance services | 28 | 20 |
| | **28** | **68** |
| **Other services** | | |
| Taxation services | - | - |
| Other non-audit services | - | - |
| **Total auditor's remuneration** | **28** | **68** |

## 7 Operating expenses

There was no further charge in 2018 (2017: €61 million) in respect of the Tracker Mortgage Examination Review. However, there was a reallocation of €11 million to interest income which reduced operating expenses during the year (see note 3). Operating expenses also include recharges from Bank of Ireland for support service costs. The Bank's day-to-day operations are almost fully outsourced to the Group under a number of service level agreements which are reviewed annually.

There were no other compensation costs paid to staff during the year (2017: €nil). No staff costs were capitalised during 2018 (2017: €nil). During 2018, the average number of employees was 5 (2017: 4 employees).

| | **2018 €m** | 2017 €m |
|---|---|---|
| Cost of Tracker Mortgage Examination Review | (11) | 61 |
| Other operating expenses | 38 | 46 |
| **Total operating expenses** | **27** | **107** |

| **Staff costs** | **2018 €'000** | 2017 €'000 |
|---|---|---|
| Wages and salaries | 511 | 417 |
| Social security costs | 55 | 45 |
| Pension costs | 93 | 82 |
| **Total staff costs recognised in the income statement** | **659** | **544** |

## 8 Net impairment gains on financial instruments

The Bank's net impairment gains on loans and advances to customers at amortised cost are set out in this table.

The comparative figures have not been restated and are presented on an IAS 39 classification and measurement basis.

| | **2018 €'000** | 2017 €'000 |
|---|---|---|
| Loans and advances to customers at amortised cost | 42,768 | 97,727 |
| *- cash recoveries* | *3,716* | *-* |
| *- movement in impairment gains* | *39,052* | *97,727* |
| Loans and advances to banks[1] | 441 | - |
| Loan commitments[1] | 85 | - |
| **Net impairment gains on financial instruments** | **43,294** | **97,727** |

| 2017 | Impairment reversal recognised in the income statement €'000 |
|---|---|
| Specific provisions | |
| - individually assessed | 5,474 |
| - collectively assessed | 33,633 |
| Incurred but not reported (IBNR) | 58,620 |
| Total | 97,727 |

## 9 Net loss on derecognition of financial assets measured at amortised cost

In 2017, the Bank sold €4.0 billion performing tracker mortgages to Bank of Ireland, resulting in a loss on sale before taxation of €447 million.

| | **2018 €m** | 2017 €m |
|---|---|---|
| Loans and advances to customers at amortised cost | - | 447 |
| **Net loss on derecognition of financial assets measured at amortised cost** | **-** | **447** |

[1] *The IAS 39 impairment charge on loans and advances to banks for 2017 was €nil. IAS 37 provisions recognised on loan commitments at 31 December 2017 were €nil.*

## 10 Taxation

| | 2018 €m | 2017 €m |
|---|---|---|
| **Current tax** | | |
| Current year | - | (13) |
| Reallocation to deferred tax | 6 | - |
| | **6** | **(13)** |
| **Deferred tax** | | |
| Trading gains / (losses) | 41 | (15) |
| Reallocation from current tax | (6) | - |
| | **35** | **(15)** |
| **Taxation charge / (credit)** | **41** | **(28)** |

| **Reconciliation of tax on the profit / (loss) before taxation at the standard Irish corporation tax rate to the Bank's actual taxation charge / (credit)** | 2018 €m | 2017 €m |
|---|---|---|
| Profit / (loss) before taxation | 342 | (227) |
| Profit / (loss) @12.5% | 43 | (28) |
| Other | (2) | - |
| **Taxation charge / (credit)** | **41** | **(28)** |

| | **2018** | | | 2017 | | |
|---|---|---|---|---|---|---|
| | **Pre-tax €m** | **Tax €m** | **Net of Tax €m** | Pre-tax €m | Tax €m | Net of Tax €m |
| **Cash flow hedge reserve** | | | | | | |
| Changes in fair value | 40 | (5) | 35 | - | - | - |
| Transfer to income statement | (20) | 2 | (18) | (22) | 3 | (19) |
| **Net change in cash flow hedge reserve** | **20** | **(3)** | **17** | **(22)** | **3** | **(19)** |

## 11 Derivative financial instruments

The Bank's use of, objectives and policies on managing the risks that arise in connection with derivatives, including the policies for hedging, are included in note 27 Risk management and control. The notional amounts of certain types of derivatives do not necessarily indicate the amounts of future cash flows involved or the current fair value of the instruments and, therefore, do not indicate the Bank's exposure to credit risk. The derivative instruments give rise to assets or liabilities as a result of fluctuations in market rates or prices relative to their terms.

The notional amounts and fair values of derivative instruments held by the Bank are set out in the table below. Derivatives held for trading comprise derivatives entered into with economic hedging intent to which the Bank does not apply hedge accounting. Derivatives classified as held for hedging in the table below comprise only those derivatives to which the Bank applies hedge accounting.

The Bank uses netting arrangements and collateral agreements to reduce its exposure to credit losses. All of the derivative assets €109 million (2017: €73 million) are available for offset against derivative liabilities under master netting arrangements. These transactions do not meet the criteria under IAS 32 to enable the assets to be presented net of the liabilities.

At 31 December 2018, cash collateral of €264 million (2017: €250 million) was held against these assets and is reported within deposits from banks (note 17).

# 11 Derivative financial instruments (continued)

| | 2018 | | | 2017 | | |
|---|---|---|---|---|---|---|
| | Contract notional amounts €m | Fair values Assets €m | Fair values Liabilities €m | Contract notional amounts €m | Fair values Assets €m | Fair values Liabilities €m |
| **Interest rate swaps** | | | | | | |
| - held for trading | 23,479 | 47 | (41) | 21,253 | 22 | (18) |
| - designated as fair value hedges | 85 | 16 | - | 96 | 19 | - |
| - designated as cash flow hedges | 3,900 | 46 | - | 3,775 | 32 | (7) |
| **Total derivative assets / (liabilities)** | | **109** | **(41)** | | **73** | **(25)** |

There are no placements with other banks in respect of the net derivative liability position of €41 million (2017: €25 million). For further information on hedging risk management, see note 27. The Bank designates certain derivatives as hedging instruments in either fair value or cash flow hedge relationships. At 31 December 2018, the Bank held the following interest rate swaps as hedging instruments.

| 2018<br>Hedging strategy | Risk category | Hedging instrument | Up to 1 year €m | 1 to 2 years €m | 2 to 5 years €m | Over 5 years €m |
|---|---|---|---|---|---|---|
| Fair value hedge | Interest rate risk | Interest rate swap | 45 | - | - | 40 |
| | | Average fixed interest rate | 5.1% | - | - | 5.5% |
| Cash flow hedge | Interest rate risk | Interest rate swap | - | 1,250 | 1,705 | 945 |
| | | Average fixed interest rate | - | 0.6% | 0.1% | 0.8% |

**Fair value hedges**

Certain interest rate derivatives are designated as hedging instruments. These are primarily used to reduce the interest rate exposure on the Bank's issued debt portfolios. The amounts relating to items designated as hedging instruments and hedge ineffectiveness for the year were as follows:

| Items designated as hedging instruments and hedge ineffectiveness<br>2018<br>Risk category | Hedging instrument[1] | Nominal amount of the hedging instrument €m | Carrying amount of the hedging instrument Assets €m | Carrying amount of the hedging instrument Liabilities €m | Changes in value used to calculate hedge ineffectiveness[2,3] €m | Ineffectiveness recognised in profit or loss[2,3] €m |
|---|---|---|---|---|---|---|
| Interest rate risk | Interest rate swaps | 85 | 16 | - | 2 | - |
| **Total** | | **85** | **16** | **-** | **2** | **-** |

| 2018<br>Line item on the balance sheet in which the hedged item is included | Carrying amount of the hedged liabilities €m | Accumulated amount of fair value adjustments on the hedged item included in the carrying amount of the hedged liabilities €m | Changes in value used to calculate hedge ineffectiveness €m | Remaining adjustments for discontinued hedges €m |
|---|---|---|---|---|
| **Interest rate risk** | | | | |
| Debt securities in issue | 100 | (15) | (2) | - |
| **Total** | **100** | **(15)** | **(2)** | **-** |

1 *All hedging instruments are included within derivative financial instruments on the balance sheet.*
2 *Ineffectiveness is included within net trading income / (expense) in the income statement.*
3 *There are no material causes of ineffectiveness in the Bank's fair value hedges.*

# 11 Derivative financial instruments (continued)

**Cash flow hedges**
The Bank designates certain interest rate and derivatives in cash flow hedge relationships in order to hedge the exposure to variability in future cash flows arising from floating rate assets. The amounts relating to items designated as hedging instruments and hedge ineffectiveness for the year were as follows:

| 2018<br>Risk category and hedging instrument[1] | Nominal amount of the hedging instrument €m | Carrying amount of hedging instrument<br>Assets €m | Carrying amount of hedging instrument<br>Liabilities €m | Changes in value used to calculate hedge ineffectiveness[2] €m | Changes in the value of the hedging instrument recognised in other comprehensive income €m | Ineffectiveness recognised in profit or loss[2,3] €m | Amount reclassified from the cash flow hedge reserve to profit or loss[3] €m |
|---|---|---|---|---|---|---|---|
| **Interest rate risk** | | | | | | | |
| Interest rate swaps | 3,900 | 46 | - | (20) | 20 | - | (20) |
| **Total** | **3,900** | **46** | **-** | **(20)** | **20** | **-** | **(20)** |

The amounts relating to items designated as hedged items for 2018 were as follows:

| 2018<br>Risk category | Changes in hedged risk used to calculate hedge ineffectiveness €m | Cash flow hedge reserve €m | Remaining adjustments for discontinued hedges €m |
|---|---|---|---|
| Interest rate risk | 20 | (36) | (2) |
| **Total** | **20** | **(36)** | **(2)** |

In 2018, there were no forecast transactions to which the Bank had applied hedge accounting which were no longer expected to occur.

Movements in the cash flow hedge reserve are shown in the Statement of changes in equity (page 16).

A reconciliation of the movements in the cash flow hedge reserve for 2018 is shown in the table.

| Cash flow hedge reserve | 2018 €m |
|---|---|
| **Changes in fair value** | |
| - Interest rate risk | 40 |
| **Transfer to income statement** | |
| **Interest income** | |
| - Interest rate risk | (14) |
| **Net trading income / (expense)** | |
| - Interest rate risk | (6) |
| Deferred tax on reserve movements | (3) |
| **Net increase in cash flow hedge reserve** | **17** |

*[1] All hedging instruments are included within derivative financial instruments on the balance sheet.*
*[2] Ineffectiveness is included within net trading income / (expense) on the income statement.*
*[3] There are no material causes of ineffectiveness in the Bank's cash flow hedges.*

## 11 Derivative financial instruments (continued)

**Cash flow hedges**
At 31 December 2017, the Bank designated certain interest rate derivatives in cash flow hedge relationships in order to hedge the exposure to variability in future cash flows arising from floating rate assets and liabilities.

Movements in the cash flow hedge are shown in the statement of changes in equity.

As of 31 December 2017, the years in which the hedge cash flows were expected to occur were as follows as required by IAS 39.

*The years the hedged cashflows are expected to occur are shown in the table below:*

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Up to 1 year €m | 1 to 2 years €m | 2 to 5 years €m | Over 5 years €m | Total €m |
| Forecast receivable cash flows | - | 4 | 15 | 12 | 31 |
| Forecast payable cash flows | - | - | - | - | - |

*The hedged cash flows are expected to impact the income statement in the following years:*

| | 2017 | | | | |
|---|---|---|---|---|---|
| | Up to 1 year €m | 1 to 2 years €m | 2 to 5 years €m | Over 5 years €m | Total €m |
| Forecast receivable cash flows | - | 4 | 15 | 12 | 31 |
| Forecast payable cash flows | - | - | - | - | - |

## 12 Other financial assets at fair value through profit or loss

From 1 January 2018 loans and advances to customers have been classified and measured in accordance with IFRS 9. For the Bank, this involved reclassifying €295 million of loans and advances to customers (before impairment provisions) from loans and receivables to financial assets mandatorily at fair value through profit or loss.

Other financial assets at fair value through profit or loss represent the Life Loan mortgage product, which was offered by the Bank until November 2010.

| **Other financial assets at fair value through profit or loss** | **2018 €m** | 2017 €m |
|---|---|---|
| Life Loans | 262 | - |
| | **262** | **-** |

The cash flows of the Life Loans are not considered to consist solely of payments of principal and interest, and as such are classified as 'fair value through profit or loss'.

Other financial assets at fair value through profit or loss are not subject to impairment under IFRS 9. For further information on the calculation of fair value, see note 28. Comparative figures have not been restated.

## 13 Loans and advances to banks

From 1 January 2018 loans and advances to banks have been classified and measured in accordance with IFRS 9. This involved reclassifying loans and advances to banks from loans and receivables to financial assets at amortised cost and measuring the associated impairment loss allowance on loans and advances to banks on a 12 month or lifetime expected credit loss approach as appropriate. The comparatives for the prior year have not been restated, with impairment provisions reflecting an IAS 39 incurred loss measurement basis.

For the purpose of disclosure of credit risk exposures, loans and advances to banks are included within other financial assets at amortised cost in note 27 on page 56.

| | **2018 €m** | 2017 €m |
|---|---|---|
| Funds placed with Bank of Ireland | 3,621 | 1,915 |
| Less impairment loss allowance on loans and advances to banks | (1) | - |
| **Total loans and advances to banks at amortised cost** | **3,620** | **1,915** |
| **Loans and advances to banks by remaining maturity** | | |
| Repayable on demand | 49 | 24 |
| 3 months or less | 3,031 | 1,356 |
| 1 year or less but over 3 months | 50 | 54 |
| 5 years or less but over 1 year | 401 | 391 |
| Over 5 years | 90 | 90 |
| Less impairment allowance | (1) | - |
| **Total loans and advances to banks at amortised cost** | **3,620** | **1,915** |

## 13 Loans and advances to banks (continued)

The table shows the movement in both the gross carrying amount and impairment loss allowance subject to 12 month Expected Credit Losses (ECL) on loans and advances to banks for 2018. All balances are receivable from Group entities and are deemed to be stage 1 for the purposes of ECL measurement.

| 2018[1]<br>Movement in loans and advances to banks | Gross carrying amount €m | Impairment loss allowance €m |
|---|---|---|
| Closing balance 31 December 2017 | 1,915 | - |
| Impact of adopting IFRS 9 on 1 January 2018 (note 31) | - | (1) |
| **Opening balance 1 January 2018** | **1,915** | **(1)** |
| Net changes in exposure | 1,706 | - |
| Loss allowance utilised | - | - |
| Measurement reclassification and other movements | - | - |
| **Closing balance at 31 December 2018** | **3,621** | **(1)** |

## 14 Loans and advances to customers at amortised cost

As set out in note 12, on transition to IFRS 9 on 1 January 2018, €295 million of loans and receivables before impairment provisions were reclassified to other financial assets at fair value through profit or loss.

From 1 January 2018 loans and advances to customers have been classified and measured in accordance with IFRS 9. This involved reclassifying loans and advances to customers from loans and receivables to either financial assets at amortised cost or financial assets mandatorily at fair value through profit or loss, and measuring the impairment loss allowance on loans and advances to customers at amortised cost on a 12 month or lifetime expected credit loss approach. The comparatives for the prior year have not been restated, with impairment provisions reflecting an IAS 39 incurred loss measurement basis.

The Bank's exposure to credit risk on loans and advances to customers is from its mortgage lending activities on residential property in the Republic of Ireland.

The following tables show the gross carrying amount, the movement in the gross carrying amount and impairment loss allowances subject to 12 month and lifetime Expected Credit Losses (ECL) on loans and advances to customers at amortised cost for the year ended 31 December 2018.

| | 2018 €m | 2017 €m |
|---|---|---|
| Loans and advances to customers at amortised cost | 15,955 | 15,411 |
| Accrued interest receivable | 13 | 14 |
| Less allowance for impairment charges on loans and advances to customers at amortised cost[2] | (324) | (464) |
| **Total loans and advances to customers at amortised cost** | **15,644** | **14,961** |
| **Loans and advances to customers at amortised cost by remaining maturity** | | |
| Repayable on demand | - | - |
| 3 months or less | 243 | 214 |
| 1 year or less but over 3 months | 570 | 552 |
| 5 years or less but over 1 year | 3,034 | 2,837 |
| Over 5 years | 12,121 | 11,822 |
| Less allowance for impairment charges on loans and advances to customers at amortised cost[2] | (324) | (464) |
| | **15,644** | **14,961** |

The opening gross carrying amount and impairment loss allowance on loans and advances to customers at amortised cost is presented as those subject to 12 month and lifetime ECL measurement following the adoption of IFRS 9, with no comparative restatement of 31 December 2017 positions.

The total amount of undiscounted expected credit losses at initial recognition on financial assets that were initially purchased or originated credit-impaired during 2018 is €nil.

1 *The opening gross carrying amount and impairment loss allowance on loans and advances to banks is presented in accordance with IFRS 9, with no comparative restatement of 2017 positions.*
2 *The comparative figures for the prior year have not been restated, with impairment provisions reflecting an IAS 39 incurred loss measurement basis.*

## 14 Loans and advances to customers at amortised cost (continued)

| 2018<br>Gross carrying amount at amortised cost (before impairment loss allowance) | Stage 1 12 month ECL (not credit-impaired) €m | Stage 2 Lifetime ECL (not credit-impaired) €m | Stage 3 Lifetime ECL (credit-impaired) €m | Purchased or originated credit-impaired €m | Total gross carrying amount €m |
|---|---|---|---|---|---|
| Closing balance 31 December 2017 | | | | | 15,411 |
| Impact of adopting IFRS 9 on 1 January 2018 (note 31) | | | | | (282) |
| **Opening balance 1 January 2018[1]** | **12,397** | **1,118** | **1,614** | **-** | **15,129** |
| Total net transfers | 211 | (164) | (47) | - | - |
| *- to 12 month ECL not credit impaired* | *701* | *(701)* | *-* | - | - |
| *- to lifetime ECL not credit impaired* | *(477)* | *637* | *(160)* | - | - |
| *- to lifetime ECL credit impaired* | *(13)* | *(100)* | *113* | - | - |
| Net changes in exposure | 1,089 | (79) | (164) | - | 846 |
| Impairment loss allowances utilised[2] | - | - | (53) | - | (53) |
| Other movements | 33 | - | - | - | 33 |
| **Gross carrying amount at 31 December 2018** | **13,730** | **875** | **1,350** | **-** | **15,955** |

| 2018<br>Impairment loss allowance | Stage 1 12 month ECL (not credit-impaired) €m | Stage 2 Lifetime ECL (not credit-impaired) €m | Stage 3 Lifetime ECL (credit-impaired) €m | Purchased or originated credit-impaired €m | Total impairment loss allowance €m |
|---|---|---|---|---|---|
| Closing balance 31 December 2017 | | | | | (464) |
| Impact of adopting IFRS 9 on 1 January 2018 (note 31) | | | | | 54 |
| **Opening balance 1 January 2018[3]** | **(2)** | **(11)** | **(397)** | **-** | **(410)** |
| Total net transfers | (4) | (11) | 15 | - | - |
| *- to 12 month ECL not credit impaired* | *(5)* | *5* | *-* | - | - |
| *- to lifetime ECL not credit impaired* | *1* | *(19)* | *18* | - | - |
| *- to lifetime ECL credit impaired* | - | 3 | (3) | - | - |
| Net impairment gains / (losses) in income statement | 3 | 12 | 24 | - | 39 |
| *- Re-measurement* | *5* | *13* | *36* | - | *54* |
| *- Net changes in exposure* | - | *1* | *12* | - | *13* |
| *- ECL model parameter and / or methodology changes* | *(2)* | *(2)* | *(24)* | - | *(28)* |
| Impairment loss allowances utilised[2] | - | - | 53 | - | 53 |
| Other movements | - | - | (6) | - | (6) |
| **Impairment loss allowance at 31 December 2018** | **(3)** | **(10)** | **(311)** | **-** | **(324)** |

[1] *The opening gross carrying amount on loans and advances to customers at amortised cost is presented in accordance with IFRS 9, with no comparative restatement of 2017 positions. The 2018 figure does not include Life Loans which were reclassified under IFRS 9 to other financial assets at fair value through profit or loss.*

[2] *Loss allowance utilised on loans and advances to customers at amortised cost during 2018 included €48 million of contractual amounts outstanding that are still subject to enforcement activity.*

[3] *The opening impairment loss allowance on loans and advances to customers at amortised cost is presented in accordance with IFRS 9, with no comparative restatement of 2017 positions.*

## 14 Loans and advances to customers at amortised cost (continued)

**Under IAS 39, impairment provisions included specific and incurred but not reported (IBNR) provisions. IBNR provisions were recognised on all categories of loans for incurred losses not specifically identified but which, experience and observable data indicated, were present in the portfolio at the date of assessment.**

The table shows the movement in impairment provisions on total loans and advances to customers under IAS 39 for 2017.

| Impairment provisions under IAS 39 | 2017 €m |
|---|---|
| Provision at 1 January 2017 | 669 |
| Reversal in income statement | (98) |
| Provisions utilised | (117) |
| Other movements | 10 |
| **Provision at 31 December 2017** | **464** |

Provisions utilised reflect impairment provisions which have been utilised against the related loan balance; the utilisation of a provision does not alter a borrower's obligations nor does it impact on the Bank's rights to take relevant enforcement action.

The Bank takes collateral as a secondary source, which can be called upon if the borrower is unable or unwilling to service and repay debt as originally assessed. The table sets out the weighted average indexed Loan to Value (LTV) for the mortgage loan book at amortised cost which showed positive movements during 2018 and was, on average, 61% at 31 December 2018 (2017: 61%).

Property values are determined by reference to the latest property valuations held[1], indexed to the Residential Property Price Index (RPPI) published by the CSO. The indexed LTV profile of the mortgage loan book in the table is based on the CSO RPPI at October 2018.

| LTV ratio of total | **2018** | | | 2017 |
|---|---|---|---|---|
| **Mortgage loan book** | **Not credit-impaired €m** | **Credit-impaired €m** | **Total €m** | Total €m |
| Less than 50% | 5,572 | 142 | 5,714 | 5,071 |
| 51% to 70% | 5,188 | 176 | 5,364 | 5,121 |
| 71% to 80% | 1,982 | 113 | 2,095 | 2,228 |
| 81% to 90% | 1,379 | 184 | 1,563 | 1,557 |
| 91% to 100% | 266 | 129 | 395 | 531 |
| **Subtotal** | **14,387** | **744** | **15,131** | **14,508** |
| 101% to 120% | 124 | 174 | 298 | 611 |
| 121% to 150% | 44 | 141 | 185 | 177 |
| Greater than 150% | 50 | 291 | 341 | 115 |
| **Subtotal** | **218** | **606** | **824** | **903** |
| **Total** | **14,605** | **1,350** | **15,955** | **15,411** |
| **Weighted average LTV[2]:** | | | | |
| Stock of mortgages at year end (%) | 56% | 113% | 61% | 61% |
| New mortgages during the year (%) | 71% | - | 71% | 69% |

## 15 Modified financial assets

The following table provides analysis of financial assets for which the contractual cash flows have been modified while they had an impairment loss allowance measured at an amount equal to lifetime expected credit loss, and where the modification did not result in derecognition.

| | 2018 €m |
|---|---|
| **Financial assets modified during the year** | |
| - Amortised cost before modification | 95 |
| - Net modification gains / (losses) on modified financial assets (net of impairment gain / (loss) impact) | - |
| **Financial assets modified since initial recognition** | |
| - Gross carrying amount of financial assets for which impairment loss allowance has changed from lifetime to 12 month expected credit losses during the year | 383 |

*[1] Loan to value profile was previously based solely on the indexation of original valuations obtained prior to loan drawdown. During 2018, the Bank completed an exercise to ensure that recent valuations from external professionals were held for all Non Performing Exposures (NPEs) in excess of €300,000 and these valuations, indexed as appropriate, have been reflected in the above table where available.*

*[2] Weighted Average LTVs are calculated at a property level and reflect the average property value in proportion to the outstanding mortgage.*

## 16 Current tax and deferred tax

The deferred tax liability of €9 million (2017: asset €34 million) includes an amount of €nil (2017: €36 million) in respect of tax losses which are available to relieve future profits from tax.

The current tax asset of €6 million at 31 December 2018 (2017: €13 million) represents tax losses that have been surrendered to other Group companies. In these cases, payments equal to the value of the losses surrendered will be received from those companies.

| | **2018 €m** | 2017 €m |
|---|---|---|
| *The movement on the deferred tax account is as follows:* | | |
| Opening deferred tax asset | 34 | 16 |
| Impact of adopting IFRS 9 on 1 January 2018 (note 31) | (5) | - |
| Cash flow hedge | (3) | 3 |
| (Charge) / credit to income statement | (35) | 15 |
| **Closing deferred tax (liability) / asset** | **(9)** | **34** |
| *Deferred tax assets and liabilities are attributable to the following items:* | | |
| *Deferred tax asset* | | |
| Unutilised tax losses | - | 36 |
| **Total deferred tax asset** | **-** | **36** |
| *Deferred tax liability* | | |
| Cash flow hedges | (4) | (2) |
| IFRS 9 transition adjustment | (5) | - |
| **Total deferred tax liability** | **(9)** | **(2)** |
| *Represented on the balance sheet as follows:* | | |
| **Deferred tax (liability) / asset** | **(9)** | **34** |

## 17 Deposits from banks

| | **2018 €m** | 2017 €m |
|---|---|---|
| **Deposits from banks** | **9,473** | **8,458** |
| **Deposits by remaining maturity** | | |
| Repayable on demand | - | - |
| 3 months or less | 1,425 | 2,371 |
| 1 year or less but over 3 months | 1,325 | 1,365 |
| 5 years or less but over 1 year | 6,391 | 4,582 |
| Greater than 5 years | 332 | 140 |
| **Due to Bank of Ireland** | **9,473** | **8,458** |

## 18 Debt securities in issue

**Asset Covered Securities (ACS)**
The Bank, as a registered designated mortgage credit institution under the Asset Covered Securities Act, 2001, established its mortgage covered securities programme (the 'Programme') in 2004. Pursuant to the Programme, the Bank may from time to time issue mortgage covered securities denominated in any currency in accordance with the provisions of the ACS Acts. ACS issued by the Bank may be listed on the Main Securities Market or the Global Exchange Market of the Irish Stock Exchange plc. ACS is secured by a statutory preference over a pool of prescribed assets known as a cover assets pool (the 'Pool'). The ACS Acts restrict and regulate the activities in which ACS issuers may engage. The Programme's most recent annual update was completed on 2 August 2018. In accordance with the ACS Acts the required disclosures are set out in note 18 (a) – 18 (h) below.

The total nominal value of mortgage covered securities in issue at 31 December 2018 amounted to €8.3 billion (2017: €7.0 billion).

| | **2018 €m** | 2017 €m |
|---|---|---|
| **Debt securities in issue** | **8,328** | **6,977** |
| **Bonds and medium term notes by remaining maturity** | | |
| 3 months or less | 779 | 730 |
| 1 year or less but over 3 months | 53 | 18 |
| 5 years or less but over 1 year | 3,948 | 4,246 |
| Greater than 5 years | 3,548 | 1,983 |
| | **8,328** | **6,977** |
| Of which is due to Bank of Ireland | 3,201 | 2,195 |

*The movement on debt securities in issue is analysed as follows:*

| | **2018 €m** | 2017 €m |
|---|---|---|
| Opening balance | 6,977 | 7,959 |
| Issued during the year | 2,071 | - |
| Redemptions | (716) | (963) |
| Purchases | - | (10) |
| Other movements | (4) | (9) |
| **Closing balance** | **8,328** | **6,977** |

**Mortgage-Backed € Promissory Notes**
The Bank participated in the ECB three year long term refinancing operation entering into a framework agreement on 28 February 2012 with the Central Bank of Ireland (CBI) under which the Bank may issue special mortgage-backed € promissory notes to the CBI. An amendment agreement dated 15 May 2014 was entered into between the CBI and the Bank and is supplemental to this framework agreement making certain amendments to its terms. The Bank's obligations under the special mortgage-backed € promissory notes are secured by way of a first floating charge over all the Bank's right, title, interest and benefit, present and future, in and to certain mortgages and related loans forming part of a mortgage pool and the benefit of all related security.

A deed of floating charge ('Deed of Charge') entered into by the Bank at the time contains a provision whereby during the subsistence of the security constituted by the Deed of Charge, otherwise than with the prior written consent of the CBI, the Bank shall:

(a) not create or attempt to create or permit to arise or subsist any encumbrance on or over the property charged under the Deed of Charge or any part thereof; or
(b) not, otherwise than in the ordinary course of business, sell, transfer, lend or otherwise dispose of the property charged under the Deed of Charge or any part thereof or redeem, agree to redeem or accept repayment in whole or in part of any loan or attempt or agree to do so whether by means of one or a number of transactions related or not and whether at one time or over a period of time.

In the past the Bank has participated in Targeted Longer-Term Refinancing Operations (TLTRO) and currently has €1 billion outstanding. €2.25 billion TLTRO has been repaid during 2018.

The Bank continued to have an option to participate in the ECB short term Main Refinancing Operations (MRO). The Bank had no MRO funds at any time during 2018 (2017: €nil).

## 18 Debt securities in issue (continued)

**(a) Mortgage accounts and principal outstanding in the cover assets pool**

| Range | | 2018 | | 2017 | |
|---|---|---|---|---|---|
| **From €'000** | **To €'000** | **Number of accounts** | **Total balances of accounts €m** | **Number of accounts** | **Total balances of accounts €m** |
| - | 100 | 40,722 | 1,820 | 38,004 | 1,714 |
| 100 | 200 | 27,641 | 4,029 | 24,003 | 3,475 |
| 200 | 500 | 16,937 | 4,767 | 12,164 | 3,357 |
| Over 500 | | 1,343 | 922 | 950 | 672 |
| | | **86,643** | **11,538** | **75,121** | **9,218** |

There could be one or more accounts per mortgaged property giving rise to different figures for the number of accounts and the number of properties in the Pool at any point in time. There were 76,374 properties in the Pool at 31 December 2018 (2017: 65,733). The total balance of accounts represents the cumulative amount outstanding on all the mortgage accounts in the Pool at 31 December 2018 and 2017 respectively.

The number of accounts represents the cumulative number of mortgage accounts held in the Pool at 31 December 2018 and 2017 respectively. There could be one or more accounts per mortgaged property giving rise to different figures for the number of accounts and the number of properties in the Pool at 31 December 2018 and 2017.

| **(b) Geographic location of mortgage properties in the cover assets pool** | **2018 Dublin** | **2018 Outside Dublin** | 2017 Dublin | 2017 Outside Dublin |
|---|---|---|---|---|
| % of overall properties | 28% | 72% | 26% | 74% |
| Number of accounts | 24,347 | 62,296 | 19,207 | 55,914 |
| Number of properties | 21,525 | 54,849 | 17,186 | 48,547 |

For the purposes of this disclosure, the term 'default' is defined as mortgage accounts that are three months or more in arrears, in line with ACS legislation.

| **(c) Mortgage accounts in default in the cover assets pool at year end** | **2018** | 2017 |
|---|---|---|
| Number of accounts in default | 107 | 24 |
| Cumulative current balance on above accounts (€m) | 16 | 5 |
| *- of which arrears represent (€m)* | - | - |

| **(d) Mortgage accounts in default in the cover assets pool with arrears of more than €1,000** | **2018** | 2017 |
|---|---|---|
| Number of accounts in the Pool during the year which were three months or more in arrears with an arrears balance greater than €1,000 | 363 | 330 |
| Number of accounts in the Pool at 31 December previously three months or more in arrears with an arrears balance greater than €1,000 | 143 | 41 |

## 18 Debt securities in issue (continued)

**(e) Replacement of non-performing assets in the cover assets pool**
For the purpose of this disclosure, the term 'non-performing assets' is as defined in the ACS Acts as 'relating to mortgage accounts that are in arrears for a period of three months or more'. During 2018, 310 accounts were non-performing (2017: 378 accounts) and were replaced with other mortgage credit assets.

**(f) Amount of interest in arrears on mortgage accounts in the cover assets pool not written off**
The total amount in arrears (including principal and interest) in respect of mortgage credit assets that are in arrears for three months or more that had not been written off at 31 December 2018 was €472,747 (2017: €104,597). €142,737 of this represented non-payment of interest (2017: €44,787).

| **(g) Total mortgage principal and interest repayments on mortgage accounts in the cover assets pool** | **2018 €m** | 2017 €m |
|---|---|---|
| Interest paid in respect of mortgage credit assets | 316 | 257 |
| Capital repaid in respect of mortgage credit assets | 1,012 | 942 |

**(h) Number and amount of mortgage accounts in the cover assets pool secured on commercial property**
At 31 December 2018 there were no mortgage accounts in the Pool that were secured on commercial property (2017: nil).

## 19 Other liabilities

Amounts owed to Bank of Ireland are unsecured, interest free and are repayable on demand. Tax and social insurance are payable at various dates over the coming months in accordance with the applicable statutory provisions.

| | **2018 €m** | 2017 €m |
|---|---|---|
| Amounts due to Bank of Ireland | 17 | 35 |
| Other liabilities | 4 | 1 |
| | **21** | **36** |

## 20 Provisions

At 31 December 2017, the Bank held a provision of €123 million in relation to the ongoing industry-wide Tracker Mortgage Examination.

| | **2018 €m** | 2017 €m |
|---|---|---|
| Opening balance | 123 | 19 |
| Charge to income statement | - | 135 |
| Provision utilised | (85) | (31) |
| **Closing balance** | **38** | **123** |

During 2018, the Bank made considerable progress in contacting and remediating the majority of the remaining impacted customers. In 2018, the Bank also reviewed a number of accounts previously remediated in 2011 (prior to the Tracker Mortgage Examination) to ensure that customers had been treated consistently. Following this review, the Bank found that some customers should have been offered the option of a tracker rate at an earlier date. These customers have now been offered redress and compensation to reflect the fact that they should have been on a tracker rate earlier (2018: €7 million). The additional redress and compensation is covered within the existing Tracker Mortgage Examination provision. Whilst there was no increase in the provision in 2018, €11 million of the provision charge was reallocated to Interest income (note 3) from Operating expenses (note 7) during the year.

The Bank utilised €85 million of the provision covering redress, compensation and related costs. The Bank expects that the majority of the remaining €38 million provision will be fully utilised within 12 months of the balance sheet date. While the redress and compensation element of the provision is largely known, there are still a number of uncertainties as to the eventual total cost of the examination and the administrative sanctions proceedings. Management has therefore exercised judgement to determine the appropriate provision in respect of certain key items in addition to the core elements of the redress and compensation to be paid to customers. These key judgemental items principally comprise the following:

- appeals: customers can pursue certain other options in respect of the determination as to whether they are impacted and the quantum of redress and compensation offered by the Bank including lodging appeals to an independent appeals panel in the 12 months after receiving their letter offering redress and compensation. In arriving at the provision, management has made estimates of the level of appeals and the associated costs of processing and settling such appeals; and
- programme costs: in determining the provision in respect of the examination, management has had to consider a range of costs associated

## 20 Provisions (continued)

with bringing the examination to an ultimate conclusion. This includes costs associated with the running of the appeals panel, tax liabilities that the Bank will settle on behalf of customers, data system costs, tracing agents and various oversight and governance processes, including any potential fine relating to the conclusion of the ongoing CBI administrative sanctions proceedings.

## 21 Loss allowance provision on loan commitments

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Closing balance 31 December 2017 | - | - |
| Impact of adopting IFRS 9 on 1 January 2018 | 173 | - |
| **Opening balance as at 1 January 2018** | **173** | **-** |
| Reversals recognised in income statement | (85) | - |
| **Closing balance** | **88** | **-** |

From 1 January 2018 loan commitments have been classified and measured in accordance with IFRS 9. This involves measuring the loss allowance provision for loan commitments on a 12 month or lifetime expected credit loss approach. At 31 December 2018, the bank held an impairment loss allowance of €0.1 million on loan commitments of €762 million which are all classified as Stage 1. Prior to adoption of IFRS 9, provisions in respect of loan commitments were measured in accordance with IAS 37 as €nil. Prior year comparatives have not been restated.

## 22 Subordinated liabilities

On 29 August 2014, the Bank availed of a €50 million interest bearing subordinated loan from its immediate parent, Bank of Ireland. The loan is subordinated in right of payment to the claims of depositors and all other senior creditors of the Bank. The interest rate on the loan is based on the three-month EURIBOR rate plus a margin of 4.3%. The loan matures on 31 August 2024. The loan may be redeemed in whole but not in part at the option of the immediate parent on the fifth anniversary and each subsequent anniversary of the issuance by giving prior notice to the Bank. Redemption in whole but not in part is at the option of the Bank upon (i) regulatory reasons (capital event) or (ii) tax reasons. Any redemption before the maturity date is subject to such approval by the Competent Authority as may be required by the Capital Requirements Regulation (CRR) and / or such other laws and regulations which are applicable to the Issuer.

On 27 October 2017, the Bank availed of a €90 million interest bearing subordinated loan from its immediate parent, Bank of Ireland. The loan is subordinated in right of payment to the claims of depositors and all other senior creditors of the Bank. The interest rate on the loan is based on the three-month EURIBOR rate plus a margin of 2.05%. The loan matures on 27 October 2027. The loan may be redeemed at the option of the Bank on the fifth anniversary and each subsequent anniversary of the issuance by giving prior notice to its immediate parent and subject to prior approval by the Competent Authority.

At 31 December 2018, total subordinated loans and accrued interest were €140 million (2017: €141 million).

## 23 Share capital and share premium

There was no share capital issued or redeemed during the years ended 31 December 2018 or 2017.

| **Authorised** | 2018 '000 Units | 2017 '000 Units |
|---|---|---|
| Units of €1 of ordinary shares | 1,000,000 | 1,000,000 |

| **Allotted, called up and fully paid – presented as equity** | 2018 €m | 2017 €m |
|---|---|---|
| Units of €1 of ordinary shares | 738 | 738 |
| Share premium | 661 | 661 |

## 24 Other equity instruments

On 27 October 2017, the Bank issued Additional tier 1 (AT1) notes with a par value of €200 million to its immediate parent.

| | 2018 €m | 2017 €m |
|---|---|---|
| Opening balance | 200 | - |
| Additional tier 1 notes issued | - | 200 |
| **Closing balance** | **200** | **200** |

The principal terms of the AT1 notes are as follows:

- the notes constitute direct, unsecured and subordinated obligations of the Bank, rank behind Tier 2 instruments and in priority to ordinary shareholders;
- the notes bear a fixed rate of interest of 5.01% until the first call date (on 27 October 2022). After the initial call date, in the event that they are not redeemed, the AT1 notes will bear interest at rates fixed periodically in advance for five-year periods based on market rates at that time;
- the Bank may elect at its sole and full discretion to cancel (in whole or in part) the interest otherwise scheduled to be paid on any interest payment date;
- the notes have no fixed redemption date, and the note holders will have no right to require the Bank to redeem or purchase the notes at any time;
- the Bank may, in its sole and full discretion but subject to the satisfaction of certain conditions elect to redeem all (but not some only) of the notes on the initial call date or semi-annually on any interest payment date thereafter. In addition, the AT1 notes are repayable, at the option of the Bank, due to certain regulatory or tax reasons. Any repayments require the prior consent of the regulatory authorities;
- the notes will be written down together with any accrued but unpaid interest if the Bank's common equity tier 1 (CET 1) ratio (calculated on an individual basis) falls below 5.125%; and
- subsequent to any write-down event the Bank may, at its sole discretion, write-up some or all of the written-down principal amount of the AT1 notes provided regulatory capital requirements and certain conditions are met.

## 25 Pension costs

The employees of the Bank are members of two pension schemes: ICS Building Society Pension Plan (ICS PP) and Bank of Ireland Group Pensions Fund (BIGPF).

The Bank is a participating employer in the ICS PP in respect of 1 employee (2017: 1 employee). The remaining 3 employees are members of the BIGPF (2017: 3 employees). The ICS PP is a defined benefit scheme based on final pensionable pay and the BIGPF scheme is a hybrid scheme, commonly known as a cash balance scheme. The schemes are operated for eligible employees of Bank of Ireland (the 'Principal Employer') and the Bank which are entities under common control.

The Principal Employer met the employer's contributions due for the Bank in 2018 and 2017 (see note 7 for details of amounts recharged). At 31 December 2018, the Bank had €nil outstanding amounts payable to the scheme (2017: €nil).

## 26 Segmental information

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

## 27 Risk management and control

**Risk management**

The Board approves policies and limits with respect to credit risk, market risk, funding and liquidity risk, operational risk, regulatory risk, conduct risk, business / strategic risk, capital adequacy risk and reputation risk. The Bank has entered into a range of service level agreements with the Group to support its overall risk management and control processes. The Head of Credit has responsibility for credit policy implementation and the Head of Finance has responsibility for financial risk policy implementation. The Group Treasury Unit has responsibility for day-to-day monitoring of market and liquidity risks. The Group Operational Risk Unit has responsibility for the operational risk framework and policy.

The Bank's risk management and control policies comply with Group risk management policies, which include reviews on a regular basis. In addition, Group control functions (e.g. Credit, Group Internal Audit, etc.) independently review compliance with policies as part of their ongoing work in the Bank. The general framework of risk management, financial and operational controls is designed to safeguard the Bank's assets.

**Definition of credit risk**

Credit risk is the risk of loss resulting from a counterparty being unable to meet its contractual obligations to the Bank in respect of loans or other financial transactions. Credit risk is a key risk for the Bank and, aside from exposures to entities within the Group, primarily arises from loans and advances to customers to purchase residential property.

Credit risk includes but is not limited to:

- Default risk: the risk that borrowers will be unable to meet the required payments on their debt obligations. This may be as a result of one or a

## 27 Risk management and control (continued)

number of factors including, but not limited to, deterioration in macroeconomic or general market conditions and deterioration in a borrower's capacity to service their debts;
- Credit concentration risk: the risk of loss due to exposures to a single borrower or group of borrowers having similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions; and
- Collateral risk: the risk of loss arising from a change in the value or enforceability of security held due to errors in the nature, quantity, pricing, or characteristics of that security.

**Credit risk management**
The Bank's credit strategy is to underwrite credit risk within a clearly defined risk appetite and risk governance framework. This is achieved through the extension of credit to customers in a manner that results in an appropriate return for the risks taken and on the capital deployed while operating within prudent risk parameters. The Bank also seeks to maximise recoveries on loans that become distressed.

The Bank's exposure to credit risk is governed by credit policy which is approved by the Board and Group Risk Policy Committee (GRPC). The credit risk function of the Group is responsible for proposing credit policy to the Board and for the management of credit risk in accordance with approved policies. Underwriting and credit management / collections' activities are centralised within the Group.

Exposures are approved only by dedicated underwriting units and according to a system of tiered individual authorities reflecting credit competence, proven judgement and experience.

The Bank's approach to the management of credit risk entails a detailed credit analysis at origination followed by early intervention and active management of accounts where creditworthiness has deteriorated. The Bank seeks to prevent loans from becoming credit-impaired and to minimise any losses through actions such as implementing forbearance solutions or action to enforce security where appropriate. Loans that are credit-impaired or at risk of becoming credit-impaired are managed by dedicated collection teams focused on working-out loans.

The Bank manages, limits and controls concentrations of credit risk by placing limits on the amounts of risk accepted in relation to one borrower or groups of borrowers. Concentrations of credit risk by geographical and industry sector are provided in a table on page 56.

Credit risk information is reported on a monthly basis to senior management. This monthly reporting includes information and detailed commentary on loan book growth, quality of the loan book, impairment loss allowances and compliance with approved risk limits.

An independent control unit within the Risk Division of the Group undertakes periodic reviews of the appropriateness of the risk rating models that are used within the business and evaluates whether the models are compliant with regulatory requirements.

Group Credit Review undertakes periodic reviews of the quality and management of the Bank's credit risk assets, including an examination of adherence to approved credit policies and procedures.

**Credit risk measurement**
All credit transactions are assessed at origination for credit quality and the borrower is assigned a credit grade based on a predefined credit rating scale. The risk, and consequently the credit grade, is reassessed periodically. The use of internal credit rating models and scoring tools, which measure the degree of risk inherent in lending to specific borrowers, is central to the credit risk assessment and ongoing management processes within the Bank.

Under IFRS 9 which was adopted by the Bank on 1 January 2018, the Bank measures impairment loss allowances for expected credit losses on essentially all credit risk exposures not measured at fair value through profit or loss. The Bank's impairment modelling methodologies are approved by the Group's Risk Measurement Committee (RMC) and the quantum of the Bank's impairment charge, non-performing exposures and impairment loss allowances are reviewed by the credit risk function of the Group in advance of providing a recommendation to the Bank's Audit Committee.
The Bank's credit risk rating systems and impairment models and methodologies play a key role in measuring credit risk and quantifying the appropriate level of impairment loss allowance. Further details are provided in the section on credit risk methodologies on page 49.

An analysis of the Bank's impairment loss allowances at 31 December 2018 is set out on page 38.

Under IAS 39, which applied for 2017, all credit exposures, either individually or collectively, were regularly reviewed for objective evidence of impairment. Where such evidence of impairment existed, the exposure was measured for an impairment provision.

**Collateral**
The Bank takes collateral as a secondary source of repayment, which can be called upon if the borrower is unable or unwilling to service and repay debt as originally assessed. The Bank's requirements around completion, valuation and management of collateral are set out in appropriate policies and procedures.

In relation to loans and advances to customers, the principal type of security taken is residential property. The Bank's credit risk processes are designed to ensure that mortgage charges are enforceable from the outset of the loan. The market value at 31 December 2018 of properties held as security for the Bank's loan book are determined by reference to the original or latest property valuations held, indexed to the October 2018 Residential Property Price Index (RPPI) published by the CSO. Typically, more frequent valuations are required for properties held as security for non-performing exposures, with an annual valuation required for non-performing exposures in excess of €300,000. During 2018, the Bank completed an exercise to ensure that recent external valuations were held for all non-performing

## 27 Risk management and control (continued)

exposures in excess of €300,000. The Bank applies Forward Looking Information (FLI) to collateral values for the purposes of measuring the impairment loss allowance. This is described on page 51.

The extent to which collateral and other credit enhancements mitigate credit risk in respect of the Bank's residential mortgage portfolio is set out on page 39. Information on repossessed collateral is set out in the table on page 56.

**Forbearance strategies**
Forbearance occurs when a borrower is granted an agreed change to a loan ('forbearance measure') for reasons relating to the actual or apparent financial stress or distress of that borrower.

The forbearance strategies adopted seek to maximise recoveries and minimise losses arising from non-repayment of debt, while providing suitable and sustainable restructure options that are supportive of customers in challenged circumstances.

A request for forbearance is a trigger event for the Bank to undertake an assessment of the customer's financial circumstances and ability to repay prior to any decision to grant a forbearance treatment. This assessment may result in a deterioration in the credit grade assigned to the loan, potentially impacting how frequently the loan must be formally reviewed. Under IFRS 9, this assessment may also result in a loan being considered to have experienced a 'significant increase in credit risk' or becoming classified as credit-impaired. Under IAS 39, this assessment may also have resulted in a loan becoming classified as impaired and subject to a specific provision.

It is the Bank's policy to measure the effectiveness of forbearance arrangements over time.

**Asset quality - loans and advances to customers**
**Asset quality methodology for 2018**
The Bank revised its asset quality reporting methodology to reflect the adoption of IFRS 9. Under the new methodology, the Bank has allocated financial instruments into one of the following categories at the reporting date:

**Stage 1 – 12 month Expected Credit Loss (ECL) (not credit-impaired):**
Loans which have not experienced a significant increase in credit risk since initial recognition and are not credit-impaired. An impairment loss allowance equal to 12-month ECL is recognised, which is the portion of lifetime ECL resulting from default events that are possible within the next 12 months.

**Stage 2 – Lifetime ECL (not credit-impaired):**
Loans which have experienced a 'significant increase in credit risk since initial recognition' and are not credit-impaired. An impairment loss allowance equal to lifetime ECL is recognised, being the ECL resulting from all possible default events over the expected life of the loan. 'Credit risk' in this context refers to the change in the risk of a default occurring over the expected life of the loan.

**Stage 3 – Lifetime ECL (credit-impaired):**
Credit-impaired loans, other than Purchased or originated credit-impaired loans. An impairment loss allowance equal to lifetime ECL is recognised. This encompasses loans where: (i) the borrower is considered unlikely to pay in full without recourse by the Bank to actions such as realising security (including 'forborne collateral realisation' loans); and / or (ii) the borrower is greater than 90 days past due and the arrears amount is material. A broader population of loans is captured than under the discontinued classification of 'impaired' which comprised exposures carrying a specific provision under IAS 39.

**Purchased or originated credit-impaired financial asset (POCI):**
Loans that were credit-impaired at initial recognition. A POCI is not subject to any initial impairment loss allowance but an impairment loss allowance is subsequently recognised for the cumulative changes in lifetime ECL since initial recognition. A POCI remains classified as such until it is derecognised, even if assessed as no longer credit-impaired at a subsequent reporting date.

The Bank continued to apply the following classifications at the reporting date:

**Forborne loans**
Loans where a forbearance measure has been granted and where the criteria to exit a forborne classification, in line with European Banking Authority (EBA) guidance[1], are not yet met. Loans that have never been forborne or loans that are no longer required to be reported as 'forborne' are classified as 'non-forborne'.

**'Forborne collateral realisation' loans (FCRs)**
Loans which meet both of the following criteria:
(i) not greater than 90 days past due; and
(ii) forbearance is in place and future reliance on the realisation of collateral is expected for the repayment in full of the loan when such reliance was not originally envisaged. Such loans are considered credit-impaired and include Split Mortgages and certain 'Interest Only' / 'Interest Only plus' arrangements.

**'Non-performing exposures' (NPEs)**
These are:
**(i)** **credit-impaired loans** which includes loans where the borrower is considered unlikely to pay in full without recourse by the Bank to actions such as realising security, including FCR cases, and loans where the borrower is greater than 90 days past due and the arrears amount is material; and
**(ii)** **other / probationary loans** that have yet to satisfy exit criteria in line with EBA guidance[1] to return to performing.

[1] *In particular the EBA's 'Implementing Technical Standards on supervisory reporting on forbearance and non-performing exposures'.*

## 27 Risk management and control (continued)

The table below provides an analysis of non-performing loans and advances to customers at amortised cost by asset classification.

| **2018** | |
|---|---|
| **Risk Profile of loans and advances to customers at amortised cost - Non-performing exposures** | **Total €m** |
| Credit-impaired | 1,350 |
| Not credit-impaired | 147 |
| **Total** | **1,497** |

| 2017[1] | |
|---|---|
| Risk Profile of loans and advances to customers at amortised cost - Non-performing exposures | Total[1] €m |
| Impaired | 802 |
| Past due greater than 90 days but not impaired | 124 |
| Neither impaired nor past due greater than 90 days | 863 |
| Total | 1,789 |

The table below summarises the composition, non-performing exposures, credit-impaired loans and impairment loss allowance of the Bank's loans and advances to customers at amortised cost at 31 December 2018.

| **2018** | **Loans €m** | **Non-performing exposures (NPEs) €m** | **Non-performing exposures as a % of loans %** | **Credit impaired loans €m** | **Total Impairment loss allowance €m** | **Total Impairment loss allowance as a % of NPEs %** | **Total Impairment loss allowance as a % of loans %** |
|---|---|---|---|---|---|---|---|
| **Total mortgages** | | | | | | | |
| Owner occupied mortgages | 14,013 | 813 | 6% | 706 | 140 | 17% | 1% |
| Buy to let mortgages | 1,942 | 684 | 35% | 644 | 184 | 27% | 9% |
| **Total** | **15,955** | **1,497** | **9%** | **1,350** | **324** | **22%** | **2%** |

The table below summarises the composition, non-performing exposures, impaired loans and impairment provisions of the Bank's loans and advances to customers at amortised cost at 31 December 2017.

| 2017[1] | Loan volumes €m | Non-perfoming exposures (NPEs) €m | Non-performing exposures as a % of advances % | Impaired loans €m | Total provisions €m | Total impairment provisions as a % of NPEs % | Specific provisions as a % of impaired loans % |
|---|---|---|---|---|---|---|---|
| Total mortgages | | | | | | | |
| Owner occupied mortgages | 13,214 | 974 | 7% | 443 | 223 | 23% | 35% |
| Buy to let mortgages | 2,197 | 815 | 37% | 359 | 241 | 30% | 53% |
| Total | 15,411 | 1,789 | 12% | 802 | 464 | 26% | 43% |

[1] *Figures for 2017 have not been restated for the impact of IFRS 9.*

## 27 Risk management and control (continued)

### Asset quality methodology for 2017

**Forborne loans**
These are defined as set out in the section 'Asset quality methodology for 2018'.

**'Forborne collateral realisation' loans (FCRs)**
These are defined as set out in the section 'Asset quality methodology for 2018'.

**'Neither past due nor impaired' ratings**
The Bank applied internal ratings to both forborne and non-forborne loans based on an assessment of the credit quality of the customer. A seven point credit grade rating scale was used for standard products.

'Neither past due nor impaired ratings' are summarised below:
- high quality ratings applies to loans to customers with whom the Bank had excellent repayment experience. High quality ratings were derived from grades 1 and 2 on the seven point grade scale;
- satisfactory quality ratings applies to good quality loans that were performing as expected. For both forborne and non-forborne loans, satisfactory quality ratings were derived from grade 3 on the seven point grade scale. In addition, satisfactory quality ratings could also apply to certain mortgage forbearance arrangements where the customer was making full interest and capital repayments;
- acceptable quality ratings applied to loans to customers with increased risk profiles that were subject to closer monitoring and scrutiny by lenders with the objective of managing risk and moving accounts to an improved rating category. For both forborne and non-forborne loans, acceptable quality ratings were derived from grade 4 on the seven point grade scale. In addition, acceptable quality ratings applied to certain mortgage forbearance arrangements where the customer was making at least full interest payments; and
- lower quality ratings applies to those loans that were neither in arrears nor impaired but where the Bank was required to work closely with the borrower regarding restructure and / or resolution. For both forborne and non-forborne loans, lower quality ratings were derived from grade 5 on the seven point grade scale. In addition, the lower quality ratings applied to certain mortgage forbearance arrangements where the customer was making less than full interest payments.

**'Non-performing exposures' (NPEs) consisted of:**
- impaired loans;
- loans past due greater than 90 days but not impaired;
- Forborne collateral realisation loans (FCRs); and
- other / probationary loans that had yet to satisfy exit criteria in line with EBA guidance to return to performing.

**'Impaired'** loans were defined as exposures which carried a specific provision whether forborne or not. Specific provisions were as a result of either individual or collective assessment for impairment.

**'Past due but not impaired'** loans, whether forborne or not, were defined as loans where repayment of interest and / or principal were overdue by at least one day but which were not impaired.

**Credit risk methodologies**
The Bank's credit risk methodologies encompass internal credit rating models and scoring tools and impairment models. A formal model risk policy is in place whereby regular performance monitoring and periodic independent validation of models is required.

**Internal credit rating models (applicable for 2017 and 2018)**
The use of internal credit rating models and scoring tools, which measure the degree of risk inherent in lending to specific counterparties, is central to the credit risk assessment and ongoing management processes within the Bank and to the calculation of regulatory capital requirements. The primary model measures used are:
- Probability of Default (PD): the probability of a given counterparty defaulting on any of its borrowings from the Bank within the next twelve months;
- Exposure at Default (EAD): the exposure the Bank has to a defaulting borrower at the time of default; and
- Loss Given Default (LGD): the loss incurred (after the realisation of any collateral) on a specific transaction should the borrower default, expressed as a percentage of EAD.

The Bank has adopted the Advanced Internal Rating Based (IRB) for its retail exposures. Under this approach, the Bank uses its own estimates of PD, LGD and credit conversion factors when calculating regulatory capital requirements.

Lending to financial institutions is assigned an internal rating supported by external ratings of the major rating agencies.

### Methodology for loan loss provisioning under IFRS 9 (applicable for 2018)

**Approach to measurement of impairment loss allowances**
Impairment is measured in a way that reflects:
(a) an unbiased and probability-weighted amount that is determined by evaluating a range of possible outcomes;
(b) the time value of money; and
(c) reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions.

Impairment on loans and advances to customers at amortised cost and associated loan commitments is measured through the use of impairment models, supplemented where necessary by management adjustments. In general, a loss allowance is recognised for all loans and loan commitments in scope for the impairment requirements of IFRS 9. However this may not be the case for very highly collateralised loans, such as mortgages at low loan to value ratios. Impairment on other financial assets at amortised cost is measured using modelled loss rates.

**Impairment models**
The Bank's impairment models are executed on a monthly basis and allocate financial instruments to stage 1, 2 or 3 and measure the appropriate 12 month or lifetime ECL. The characteristics of an exposure determine which impairment model is used, with market segment being a key influencing factor (e.g. owner occupier, buy-to-let).

ECL are calculated as the sum of the marginal losses for each time period from the balance sheet date. The key components of the ECL calculation are Probability of Default (PD), Exposure at

## 27 Risk management and control (continued)

Default (EAD) and Loss Given Default (LGD, which is expressed as a percentage of EAD) as described below. While similar components are used for regulatory capital purposes, regulatory conservatism has not been applied in the impairment models in order to comply with the requirement under IFRS 9 to be unbiased.

**IFRS 9 PD**
Where available, the ratings or underlying scores from internal credit rating models are used as a starting point for IFRS 9 PD calibration. A current point-in-time IFRS 9 PD is calculated as the expected default rate over the next 12 months. This PD is used in the calculation of 12-month ECL and as a starting point in the calculation of lifetime PD.

Together, the current point-in-time IFRS 9 PD and future point-in-time IFRS 9 PDs are used to generate an IFRS 9 lifetime PD expectation for each Forward Looking Information (FLI) scenario. The scenario weighted averages are used to generate an overall IFRS 9 lifetime PD expectation. As lifetime PD was not calculated historically, the Bank used reasonable and supportable information available without undue cost or effort to approximate the residual IFRS 9 lifetime PD expectations at initial recognition for most loans originated prior to the adoption of IFRS 9 on 1 January 2018.

**IFRS 9 EAD**
Current point-in-time EAD is the expected exposure at default were the borrower to default within the next 12 months. Future point-in-time EAD also incorporates expected contractual cash flows.

**IFRS 9 LGD**
Current point-in-time LGD is the loss that would be incurred should default occur in the next 12 months. To facilitate the calculation of lifetime ECL, future point-in-time LGDs are calculated for each year from the start of year 2 to maturity of the exposure.

**Identifying a significant increase in credit risk**
The Bank's standard criteria to identify financial instruments which have had a 'significant increase in credit risk since initial recognition' are applied to loans and advances to customers at amortised cost. 'Credit risk' in this context refers to the change in the risk of a default occurring over the expected life of the loan. Unless credit-impaired, a loan is generally allocated to stage 2 if any of the following criteria are met at the reporting date:

- remaining lifetime PD is more than double and >50bps higher than the remaining lifetime PD at the reporting date as estimated based on facts and circumstances as at initial recognition (adjusted where relevant for changes in prepayment expectations);
- a contractual payment is greater than 30 days past due; and / or
- the exposure is a forborne loan or a non-performing exposure.

The above criteria are applied as part of the monthly execution of the Bank's impairment models. In addition, management considers whether there is reasonable and supportable information that would not otherwise be taken into account that would indicate that a significant increase in credit risk had occurred.

Where a financial asset has been modified but not derecognised, the quantitative assessment of 'significant increase in credit risk' continues to be based on the remaining lifetime PD at the reporting date as estimated based on facts and circumstances as at initial recognition (adjusted where relevant for changes in prepayment expectations).

The Bank assesses the effectiveness of its staging criteria semi-annually, taking into account considerations such as the extent to which:

(i) exposures have moved directly from stage 1 to stage 3;
(ii) exposures have moved to stage 3, having spent only a short period in stage 2;
(iii) exposures have moved frequently between stages 1 and 2; and
(iv) there is potential over-reliance on backstop or qualitative criteria in identifying stage 2 exposures.

The Bank applies the low credit risk expedient to loans and advances to banks. Low credit risk encompasses PD grades 1 to 5 on the Bank's internal PD rating system, which broadly aligns with ratings of AAA to BBB- for the external major rating agencies. Such financial instruments have been allocated to stage 1.

**Identifying defaulted assets and credit-impaired assets**
The Bank's definition of default for impairment purposes (i.e. for the purposes of allocating loans to 'stages' and for measuring impairment loss allowances under IFRS 9) is consistent with its application of the definition of default in Article 178 of the Capital Requirements Regulations (CRR) noting that IFRS 9 requires the Bank to use a definition which is consistent with that used for internal credit risk management purposes. The Bank considers certain events as resulting in mandatory default and credit-impaired classification without further assessment. These include:

- greater than 90 days past due and the past due amount is material;
- a forbearance arrangement is put in place where future reliance on realisation of collateral is expected for repayment in full when this was not originally envisaged;
- legal action is underway by the Bank to enforce repayment or realise security;
- the Bank or a receiver takes security into possession; and
- the Bank has formally sought an insolvency arrangement in respect of the borrower.

Certain other events necessitate a lender assessment and, if the outcome of the lender assessment is that the contractual amount of principal and interest will not be fully repaid in what is assessed to be the most likely cash flow scenario, default and credit-impaired classification is mandatory. For larger value cases (typically where total customer exposure exceeds €1 million), the lender assessment involves production of an individual discounted cash flow analysis.

The events include:

- a forbearance measure has been requested by a borrower and formally assessed;
- the contractual maturity date has passed without repayment in full;
- it becomes known that the borrower has formally sought an insolvency arrangement;
- offer of voluntary surrender of security or sale of security at a possible shortfall; or
- it becomes known that the borrower has become unemployed with no comparable new employment secured.

## 27 Risk management and control (continued)

**Review of credit-impaired loans**
It is Bank policy to review credit-impaired loans above agreed thresholds semi-annually or on receipt of material new information, with the review including a reassessment of the recovery strategy and the continued appropriateness of a credit-impaired classification. The minimum requirements for a credit-impaired loan to return to non credit-impaired status are that the borrower must not be greater than 90 days past due on a material amount, the borrower must be considered likely to pay in full without recourse by the Bank to actions such as realising security and there must be no forbearance arrangement in place where future reliance on realisation of collateral is expected for repayment in full when this was not originally envisaged. Typically, an updated assessment of the borrower's current financial condition and prospects for repayment is required with the borrower to have satisfactorily met repayments required under the original or modified agreement regularly for a reasonable period of time.

**Forward Looking Information (FLI)**
FLI refers to probability-weighted future macroeconomic scenarios approved semi-annually by the GRPC and used in the assessment of 'significant increase in credit risk' and in the measurement of impairment loss allowances under IFRS 9. The Bank generally uses three Republic of Ireland FLI scenarios, being a central scenario, an upside scenario and a downside scenario, all extending over a five year forecast period. The central scenario is based on internal and external information and management judgement, with the other scenarios and the probability weightings generated by a model which additionally takes into account historical data and chosen severity percentiles.

Typically, one or two macroeconomic variables are incorporated into each impairment model, being those determined to be most relevant to forecasting default. The lifetime PD expectation for an exposure generated under each of the scenarios, weighted by the probability of each scenario occurring, is used to generate the lifetime PD expectations used for the assessment of 'significant increase in credit risk'. Forecasts of residential property price growth are incorporated as appropriate into the LGD component of the ECL calculation. The overall ECL for an exposure is determined as a probability-weighted average of the ECL calculated for each scenario, weighted by the probability of each scenario occurring. Beyond the forecast period, default rates are assumed to revert over time to an observed long run average and the value of property collateral for LGD purposes is assumed to grow at an observed long-run rate.

| Republic of Ireland | Downside | Central | Upside |
|---|---|---|---|
| Severity percentile | 85th | 50th | 15th |
| Scenario probability weighting | 30% | 39% | 31% |
| GNP growth | 1.1% | 2.8% | 5.2% |
| Unemployment rate | 6.4% | 5.0% | 4.3% |
| Residential property price growth | (3.0%) | 2.1% | 8.1% |

The above table shows the mean average forecast values for some of the key macroeconomic variables under each scenario for the five year forecast period 2019-2023 together with the associated percentiles and probability weightings.

FLI is generally not applied to exposures to which the low credit risk expedient has been applied.

**Management adjustment**
To ensure that the measurement of impairment reflects reasonable and supportable information that is available without undue cost or effort at the reporting date about past events, current conditions and forecasts of future economic conditions, the need for a management adjustment to the outputs of the Bank's staging and impairment measurement methodologies is considered at each reporting date in arriving at the final impairment loss allowance. Such a need may arise, for example, due to a model limitation or late-breaking event. A management adjustment was applied at 31 December 2018 and is detailed on page 29.

**Methodology for loan loss provisioning under IAS 39 (applicable for 2017)**

All credit exposures, either individually or collectively, were regularly reviewed for objective evidence of impairment. Where such evidence of impairment existed, the exposure was measured for an impairment provision.

At 31 December 2017, events requiring the completion of an impairment assessment to determine whether a loss event had occurred at the balance sheet date that might lead to recognition of impairment losses included:
- loan asset had fallen 90 days past due;
- a forbearance measure had been requested by a borrower and formally assessed;
- notification of, or intended application for, bankruptcy proceedings, debt settlement or personal insolvency arrangement or similar; and
- offer of voluntary sale at possible shortfall or voluntary surrender of property security.

Where objective evidence of impairment existed, as a result of one or more past events, the Bank was required to estimate the recoverable amount of the loan.

For financial reporting purposes, loans on the balance sheet that became impaired were written down to their estimated recoverable amount. The amount of this write down was taken as an impairment charge in the income statement. Impaired loans had a specific provision attaching.

**Methodology for individually assessing impairment**
An individual impairment assessment was performed for any exposure for which there was objective evidence of impairment and where the exposure was above an agreed threshold. For residential mortgages, a de-minimis total customer exposure level of €1 million applied for the mandatory completion of a discounted cash flow (DCF) analysis for the assessment of impairment. The carrying amount of the exposure net of the estimated recoverable amount (and thus the specific provision required) was calculated using DCF analysis. This calculated the estimated recoverable amount as the present value of the estimated future cash flows, discounted at the exposure's original effective interest rate (or the current effective interest rate for variable rate exposures). The estimated future cash flows included forecasted

## 27 Risk management and control (continued)

principal and interest payments (not necessarily contractual amounts due) including cash flows, if any, from the realisation of collateral / security held, less realisation costs.

**Methodology for collectively assessing impairment**
Exposures which fell below the threshold for individual assessment, or did not otherwise require individual assessment, were pooled together and a provision calculated by a collective specific provisioning model. The provision estimation considered the expected contractual cash flows and the historical loss experience. Assumptions and parameters used, which were based on historical experience (i.e. amount and timing of cash flows / LGD) were regularly compared against current experience in the loan book and current market conditions.

Some of the key parameters used in the collective specific provisioning model at 31 December 2017 related to:

- indexed residential property valuation[1];
- forced sale discount (23% to 55%);
- workout costs (7%);
- weighted average cure rate (33.43% over three years, with cure assumptions segmented by: forbearance classification and region (for relevant cohorts));
- weighted average repayment rate (5.91% over three years); and
- time to sale (3.5 years from the reporting date).

The provisioning model assumptions and parameters used historical loan loss experience adjusted where appropriate for current conditions and current observable data. Cure assumptions reflected the definition of cure per the CBI 'Impairment Provisioning and Disclosure Guidelines' (May 2013, withdrawn 1 January 2018) which required satisfactory completion of a 12 month probation period, while being less than 30 days past due.

Where there was objective evidence of impairment on a collective basis, this was reported as a specific provision (collective specific) in line with individually assessed loans.

**Methodology for establishing incurred but not reported (IBNR) provisions**
Impairment provisions were also recognised for losses not specifically identified but which, experience and observable data indicated, were present in the portfolio / group of exposures at the date of assessment. These were described as incurred but not reported provisions. Statistical models were used to determine the appropriate level of IBNR provisions for a portfolio / group of exposures with similar credit risk characteristics (e.g. asset type, geographical location, forbearance classification) taking into account the following estimates / assumptions:

- loss emergence rates (based on historic grade migration experience and current PD grades, offset by cure expectations where appropriate);
- the emergence period (historic experience adjusted to reflect current conditions); and
- LGD rates (loss and recovery rates using historical loan loss experience, adjusted where appropriate to reflect current observable data).

A key assumption used in the calculation of the IBNR provisions for past due greater than 90 days but not impaired mortgages was the value of underlying residential properties securing the loans. The IBNR provisioning model parameters and assumptions were reviewed during 2017 informed by the most recent observed experience (including updated residential property sales data). The resulting updates, particularly in relation to the residential property value assumptions, the forced sale discounts and work-out costs used in the IBNR provisioning model, were the same as those outlined above in respect of the collective specific provisioning methodology.

Emergence period referred to the period between occurrence and reporting of a loss event. At 31 December 2017, emergence periods ranged from 6 to 20 months for both forborne and non-forborne mortgages. Emergence periods were based on historic loan loss experience supported by back testing and, as appropriate, individual case sampling.

The LGD was calculated using historical loan loss experience and was adjusted where appropriate to apply management's credit expertise to reflect current observable data (including an assessment of any changes in the property sector, discounted collateral values and repayment prospects).

**Methodology for loan loss provisioning and forbearance**
***Individually assessing impairment and forbearance***
The methodology for individually assessing impairment, whether an exposure was forborne or not, was as outlined above (i.e. on an individual case-by-case basis).

***Collectively assessing impairment and forbearance[2]***
Forborne exposures were pooled together for collective impairment provisioning, including IBNR provision calculations. Assumptions and parameters used to create provision(s) took into consideration the historical experience on assets subject to forbearance (e.g. amount and timing of cash flows, cure experience, emergence period), adjusted where appropriate to reflect current conditions, and required the satisfactory completion of a twelve month probation period, while being less than 30 days past due.

***Provisioning and forbearance***
Exposures which were subject to forbearance and had a specific provision were reported as both 'forborne' and 'impaired'. The total provision book cover on forborne loans was reflective of the additional credit risk inherent in such loans, particularly the potentially higher risk of default and / or re-default.

---

[1] *Indexed value with reference to end September 2017 Central Statistics Office (CSO), Residential Property Price Index (RPPI) for 'Dublin - all residential properties' and 'National excluding Dublin - all residential properties' (hereafter 'Non-Dublin'). At that date, the Dublin index was 24% lower than its peak and the non-Dublin index was 29.8% lower than its peak. The end September CSO index was published on 8 November 2017 and was used in the updating of the Retail Ireland mortgage collective impairment provisioning parameters and assumptions, which were approved internally for year ended 31 December 2017.*

[2] *For collective provisioning purposes, the Bank applied a definition of forbearance that was aligned with the Central Bank of Ireland's 'Impairment Provisioning & Disclosures Guidelines' 2013. These guidelines were withdrawn on 1 January 2018 when IFRS 9 became effective.*

## 27 Risk management and control (continued)

**Loans and advances to customers – IAS 39 comparative disclosures**
Under IAS 39, impairment provisions included specific and incurred but not reported (IBNR) provisions. IBNR provisions were recognised on all categories of loans for incurred losses not specifically identified but which, experience and observable data indicated, were present in the portfolio at the date of assessment. The following table shows the reversal of impairment recognised in the Bank's 2017 income statement and an analysis of the impairment provision as at 31 December 2017. The table is presented on an IAS 39 measurement and classification basis.

| 2017 | Impairment reversal recognised in the income statement €m | Impairment provision in the balance sheet €m |
|---|---|---|
| Specific provisions | | |
| - individually assessed | (5) | 235 |
| - collectively assessed | (34) | 110 |
| Incurred but not reported (IBNR) | (59) | 119 |
| Total | (98) | 464 |

### Asset quality

The table below illustrates the relationship between the Bank's internal credit risk rating grades as used for credit risk management purposes and Probability of Default (PD) percentages, and further illustrates the indicative relationship with credit risk ratings used by external rating agencies.

| Internal credit risk ratings | | |
|---|---|---|
| **PD Grade** | **PD %** | **Indicative S&P type external ratings** |
| 1-4 | 0% ≤ PD < 0.26% | AAA, AA+, AA, AA-, A+, A, A-, BBB+ |
| 5-7 | 0.26% ≤ PD < 1.45% | BBB, BBB-, BB+, BB |
| 8-9 | 1.45% ≤ PD < 3.60% | BB-, B+ |
| 10-11 | 3.60% ≤ PD < 100% | B, Below B |
| 12 (credit impaired) | 100% | n/a |

The following disclosures provide quantitative information about credit risk within financial instruments held by the Bank.

### Financial assets

*Composition and risk profile*

The table below summarises the composition and risk profile of the Bank's financial assets subject to impairment. Comparative figures have not been restated and are presented on an IAS 39 classification and measurement basis.

| | **2018** | | | | | 2017 |
|---|---|---|---|---|---|---|
| **Financial assets exposure by stage (before impairment loss allowance)** | **Stage 1 - (not credit-impaired) €m** | **Stage 2 - (not credit-impaired) €m** | **Stage 3 - (credit-impaired) €m** | **Purchased or originated credit impaired €m** | **Total €m** | Total €m |
| **Financial assets measured at amortised cost** | | | | | | |
| Loans and advances to customers[1] | 13,730 | 875 | 1,350 | - | 15,955 | 15,411 |
| Loans and advances to banks | 3,621 | - | - | - | 3,621 | 1,915 |
| Other financial assets | 2 | - | - | - | 2 | 3 |
| **Total financial assets measured at amortised cost[2]** | **17,353** | **875** | **1,350** | **-** | **19,578** | **17,329** |

[1] *Loans and advances to customers at amortised cost excludes €262 million of loans mandatorily at fair value through profit or loss at 31 December 2018 which are not subject to impairment under IFRS 9 and are thereby excluded from impairment related tables (see note 12).*
[2] *The above table excludes loan commitments of €762 million that are subject to impairment (see note 21).*

## 27 Risk management and control (continued)

*Impairment loss allowance*
The impairment loss allowance on financial assets is set out in the table below. Comparative figures have not been restated and are presented on an IAS 39 classification and measurement basis.

| | 2018 | | | | | 2017 |
|---|---|---|---|---|---|---|
| **Impairment loss allowance on financial assets** | **Stage 1 - (not credit-impaired) €m** | **Stage 2 - (not credit-impaired) €m** | **Stage 3 - (credit-impaired) €m** | **Purchased or originated credit impaired €m** | **Total €m** | Total €m |
| **Financial assets measured at amortised cost** | | | | | | |
| Loans and advances to customers[1] | 3 | 10 | 311 | - | 324 | 464 |
| Loans and advances to banks | 1 | - | - | - | 1 | - |
| Other financial assets | - | - | - | - | - | - |
| **Total financial assets measured at amortised cost[2]** | **4** | **10** | **311** | **-** | **325** | **464** |

There was €nil impairment on loans and advances to banks and other financial assets at 31 December 2017.

**Loans and advances to customers at amortised cost**
*Composition and risk profile*
The table below summarises the composition and risk profile of the Bank's loans and advances to customers at amortised cost. Comparative figures have not been restated and are presented on an IAS 39 classification and measurement basis.

| | 2018 | | | | 2017 | |
|---|---|---|---|---|---|---|
| **Loans and advances to customers Composition and risk profile (before impairment loss allowance)** | **Not credit-impaired €m** | **Credit-impaired €m** | **Total €m** | **Total %** | **Total €m** | **Total %** |
| Owner occupied mortgages | 13,307 | 706 | 14,013 | 88% | 13,214 | 86% |
| Buy to let mortgages | 1,298 | 644 | 1,942 | 12% | 2,197 | 14% |
| **Total** | **14,605** | **1,350** | **15,955** | **100%** | **15,411** | **100%** |
| **Impairment loss allowance on loans and advances to customers** | **13** | **311** | **324** | **2%** | **464** | **3%** |

[1] *Loans and advances to customers at amortised cost excludes €262 million of loans mandatorily at fair value through profit or loss at 31 December 2018 which are not subject to impairment under IFRS 9 and are thereby excluded from impairment related tables (see note 12).*
[2] *The above table excludes loan commitments of €762 million that are subject to impairment (see note 21).*

## 27 Risk management and control (continued)

**Asset quality – not-credit impaired**

The table below summarises the composition and impairment loss allowance of the Bank's loans and advances to customers at amortised cost that are not-credit impaired.

| 2018 | Stage 1 | | | | Stage 2 | | | |
|---|---|---|---|---|---|---|---|---|
| Not-credit impaired loans and advances to customers - Composition and impairment loss allowance | Loans €m | Loans as % of total advances % | Impairment loss allowance €m | Impairment loss allowance as % of loans % | Loans €m | Loans as % of total advances % | Impairment loss allowance €m | Impairment loss allowance as % of loans % |
| **Total mortgages** | | | | | | | | |
| Owner occupied mortgages | 12,613 | 79% | 2 | - | 694 | 4% | 6 | 1% |
| Buy to let mortgages | 1,117 | 7% | 1 | - | 181 | 1% | 4 | 2% |
| **Total** | **13,730** | **86%** | **3** | **-** | **875** | **5%** | **10** | **1%** |

The table below provides analysis of the asset quality of loans and advances to customers at amortised cost that are not credit impaired based on mapping the IFRS 9 12 month PD of each loan to a PD grade based in the table on page 53.

| 2018<br>Not-credit impaired loans and advances to customers (before impairment loss allowance) | Stage 1 | | Stage 2 | | Total | |
|---|---|---|---|---|---|---|
| Asset quality | €m | % | €m | % | €m | % |
| **PD grade** | | | | | | |
| 1-4 | 10,549 | 77% | 63 | 7% | 10,612 | 73% |
| 5-7 | 2,617 | 19% | 106 | 12% | 2,723 | 19% |
| 8-9 | 391 | 3% | 247 | 28% | 638 | 4% |
| 10-11 | 173 | 1% | 459 | 53% | 632 | 4% |
| **Total not credit impaired** | **13,730** | **100%** | **875** | **100%** | **14,605** | **100%** |

**Asset quality – credit-impaired**

The table below summarises the composition and impairment loss allowance of the Bank's loans and advances to customers at amortised cost that are credit-impaired (i.e. stage 3).

| 2018<br>Credit-impaired loans and advances to customers<br>Composition and impairment loss allowance | Credit-impaired loans €m | Credit-impaired loans as % of total advances % | Impairment loss allowance €m | Impairment loss allowance as % of credit-impaired loans % |
|---|---|---|---|---|
| Owner occupied mortgages | 706 | 4% | 132 | 19% |
| Buy to let mortgages | 644 | 4% | 179 | 28% |
| **Total credit-impaired** | **1,350** | **8%** | **311** | **23%** |

All loans and advances to customers that are greater than 90 days past due are classified as being credit-impaired. All credit-impaired loans and advances to customers are risk rated PD grade 12.

## 27 Risk management and control (continued)

**Concentration of risks of financial assets with credit risk exposure**

*(i) Geographical sectors*
The table below analyses the Bank's main credit exposure for loans and advances to customers at amortised cost before impairment provisions, as categorised by geographical region. For this table, the Bank has allocated exposures based on the location of the asset.

| Loans and advances to customers at amortised cost | 2018 €m | 2017 €m |
|---|---|---|
| Dublin | 6,413 | 6,025 |
| Rest of Republic of Ireland | 9,542 | 9,386 |
| **Total** | **15,955** | **15,411** |

*(ii) Industry sectors*
All loans and advances to banks and derivative financial instruments are categorised as financial assets or liabilities with banks. All derivatives and loans and advances to banks are transacted with Bank of Ireland. Loans and advances to customers are all categorised as Personal (residential mortgages).

**Repossessed collateral**
At 31 December 2018, the Bank had 59 properties in possession (2017: 65 properties). Repossessed property is sold as soon as practicable, with the proceeds used to reduce indebtedness. The value of these properties is as follows:

| Repossessed collateral | 2018 €m | 2017 €m |
|---|---|---|
| Residential mortgages | 13 | 16 |

**IAS 39 comparatives**
**Risk profile of loans and advances to customers**
The table and analysis below summarise the Bank's loans and advances to customers over the following categories: 'neither past due or impaired', 'past due but not impaired' and 'impaired'. Exposures are before provisions for impairment.

| Risk profile of loans and advances to customers (before impairment provisions) | 2017 €m |
|---|---|
| High quality | 12,840 |
| Satisfactory quality | 521 |
| Acceptable quality | 823 |
| Lower quality but neither past due nor impaired | 60 |
| Neither past due nor impaired | 14,244 |
| Past due up to 30 days | 161 |
| Past due 31 - 60 days | 50 |
| Past due 61- 90 days | 30 |
| Past due greater than 90 days but not impaired | 124 |
| Past due but not impaired | 365 |
| Impaired | 802 |
| Total past due and impaired | 1,167 |
| Total loans and advances to customers | 15,411 |

**Other financial assets at amortised cost**
**Asset quality**
Other financial assets subject to impairment under IFRS 9 include loans and advances to banks and amounts receivable. The impairment loss allowance on other financial assets at amortised cost is €1 million at 31 December 2018. None of the balance is credit-impaired. There was no impairment in 2017. For both years, all other financial assets at amortised cost were performing fully in line with their terms with no amounts past due. These balances relate to receivables from Bank of Ireland which is rated BBB+.

## 27 Risk management and control (continued)

**Financial instruments at fair value through profit or loss**

Financial instruments at FVTPL include derivatives and Life Loans. The table summaries the asset quality of these financial instruments by equivalent external ratings. These financial instruments are not subject to impairment under IFRS 9.

| Financial instruments at fair value through profit or loss with ratings equivalent to: | 2018 €m | 2018 % | 2017 €m | 2017 % |
|---|---|---|---|---|
| AAA to AA- | - | - | - | - |
| A+ to A- | - | - | - | - |
| BBB+ to BBB- | 109 | 29% | 73 | 100% |
| BB+ to BB- | - | - | - | - |
| B+ to B- | 258 | 70% | - | - |
| Lower than B- | 4 | 1% | - | - |
| **Total** | **371** | **100%** | **73** | **100%** |

**Maximum exposure to credit risk before collateral held or other credit enhancements**

The table below represents a worst case scenario of credit risk exposure to the Bank, without taking account of any collateral held or other credit enhancements attached. The exposures are based on net carrying amounts, net of provisions, as reported in the balance sheet, adjusted for deferred acquisition costs.

| Maximum exposure | 2018 €m | 2017 €m |
|---|---|---|
| Loans and advances to banks | 3,620 | 1,915 |
| Loans and advances to customers at amortised cost[1] | 15,446 | 14,808 |
| Other financial assets at fair value through profit or loss[1] | 262 | - |
| Derivative financial instruments | 109 | 73 |
| Commitments | 762 | 1,307 |
| **Total** | **20,199** | **18,103** |

**Market risk**

Market risk is the risk of loss arising from movements in interest rates, foreign exchange rates or other market prices. Market risk arises naturally through customer lending and wholesale funding.

The management of market risk in the Bank is governed by Group policy, approved by both the Group's and the Bank's Boards of Directors. The Bank complies with this policy.

Group Market and Liquidity risk is responsible for ensuring that the Bank identifies, understands and measures the market risks to which it is exposed. It is charged with maintaining a policy framework and a set of methods to quantify market risk that are appropriate and fit for purpose and with operating effective monitoring and reporting arrangements that ensures compliance with policy, limits and other controls. The current interest rate risk strategy aims to provide the Bank with protection against material adverse changes in interest and related funding rates by undertaking controlled management of the interest rate structure in the Bank's mortgage and funding products. The Bank has entered into a range of service level agreements with Bank of Ireland to support its overall risk management and control processes. The Group Treasury Unit has responsibility for day-to-day monitoring of market and liquidity risks. The Bank has a formal structure for managing risk, including established risk limits, reporting lines, mandates and other control procedures.

***Loans and advances to customers at amortised cost***

At 31 December 2018, the Bank had €7.3 billion (2017: €8.6 billion) of floating-rate loans and advances to customers at amortised cost, where the interest rate is either linked to the ECB Base rate or the Bank's standard variable rate.

The Bank enters into interest rate swaps to hedge the interest rate exposure on floating rate mortgages against which asset covered securities are issued. These interest rate swaps and related floating rate mortgages qualify for cash flow hedge accounting. At 31 December 2018, the nominal value of swaps qualifying for hedge accounting was €4.0 billion (2017: €3.8 billion). Further details are provided in note 11.

At 31 December 2018, the Bank had €8.7 billion (2017: €6.5 billion) of loans and advances to customers at amortised cost, where the rate is typically fixed for periods of 1, 2, 3, 5 and 10 years. The interest rate exposure of the Bank relating to its Irish residential loans is managed through maturity matched borrowing from the Group resulting in no material sensitivity to changes in interest rates.

***Other financial assets at fair value through profit or loss***

At 31 December 2018, the Bank had €0.3 billion (2017: €0.3 billion) of 'Life Loan' (equity release) loans and advances to customers, where the rate was initially fixed for 15 years and customers do not make any periodic repayments. The outstanding loan balance increases through the life of the loan as the interest

[1] *Balances have not been restated for 2017.*

## 27 Risk management and control (continued)

due is capitalised on a quarterly basis. The mortgage is typically repaid out of the proceeds of the sale of the property. The interest rate exposure of the Bank is hedged on a behavioural basis through a mix of short term variable and longer term fixed rate funding in line with the expected 'Life Loan' mortgage redemption profile.

***Asset Covered Securities***
At 31 December 2018, the Bank had (nominal) €8.3 billion in issued asset covered securities (2017: €6.9 billion). €5.1 billion of the issued asset covered securities are at fixed rates (2017: €4.7 billion) and the remaining €3.2 billion have an interest rate that resets based on short-dated EURIBOR (2017: €2.2 billion).

The Bank also enters into interest rate swaps to hedge the interest rate exposure on its fixed rate asset covered securities in issue. The majority of these interest rate swaps and related fixed rate issued asset covered securities qualify for fair value hedge accounting. At 31 December 2018, the nominal value of swaps qualifying for fair value hedge accounting is €0.1 billion (2017: €0.1 billion). Further details are provided in note 11.

Additionally, market risk arises where the rate charged on variable rate mortgage lending resets with changes in ECB rates, but the related funding is at short-dated EURIBOR. The Bank enters into interest rate swaps to economically hedge this risk. These interest rate swaps do not qualify for hedge accounting and the Bank is exposed to potential income statement volatility of c.€0.1 million for a one basis point movement in rates.

The Bank measures its interest rate risk in terms of the sensitivity of its fixed rate mortgage assets and related funding, in net present value terms, to a 1% parallel shift in the yield curve. The Bank is required to ensure that this sensitivity remains within a low operational hedging limit of €1.4 million. At 31 December 2018, the Bank's exposure to a parallel 1% upward shift in the euro yield curve was €0.4 million (2017: €0.02 million).

Additionally, to comply with the ACS Acts, the Bank is required to manage the interest rate sensitivity of all of its assets and liabilities to a 10% of own funds limit (Equity, Tier 1 and 2). This is monitored by the Cover Asset Monitor on behalf of the Central Bank of Ireland.

**Currency risk**
The Bank is not exposed to currency risk as all financial assets and liabilities are denominated in euro.

**Funding and liquidity risk**
Funding and liquidity risk is the risk that the Bank will experience difficulty in financing its assets and / or meeting its contractual payment obligations as and when they fall due, or will only be able to do so at substantially above the prevailing market cost of funds.

Liquidity risk arises from differences in timing between cash inflows and outflows. Cash inflows are driven, among other things, by the maturity structure of loans held by the Bank, while cash outflows are driven, inter alia, by the term of the debt issued by the Bank. Liquidity risk can increase due to the unexpected lengthening of maturities or non-repayment of assets, or the inability to refinance maturing debt. These factors are often associated with times of distress or adverse events such as a credit rating downgrade(s) or economic or financial turmoil. The Bank has established a risk management framework to manage this risk.

Funding risk can occur where there is an over-reliance on a particular type of funding, a funding gap or a concentration of wholesale funding maturities. The Bank's ability to access funding markets at a sustainable cost and in a sufficient volume can be negatively impacted by a credit rating downgrade(s) or deterioration in market sentiment which in turn could impact its financial position.

The Bank's Board has approved a funding policy for the business that permits funding through the use of asset covered securities, residential Mortgage-Backed Promissory Note programmes and borrowings from the Group. It is the Bank's policy to ensure that resources are at all times available to meet the Bank's obligations arising from mortgage products, asset covered securities, capital and expenditure. The management of liquidity is the responsibility of the Bank, supported by the Group Treasury Unit. The Bank has outsourced the responsibility for the day to day monitoring and management of liquidity risk to the Group Treasury Unit. The Group Treasury Unit consolidates the Bank's cash flows into the Bank of Ireland liquidity centre, where a cash flow liquidity reporting tool provides daily liquidity risk information by designated cash flow buckets, which is used to manage liquidity risk. This system captures the cash flows from both balance sheet and off-balance sheet transactions. In the case of specific products such as mortgage repayments and off-balance sheet commitments, behavioural adjustments are applied to reflect the Bank's experience of these cash flows based on historical trends.

The Bank is also required to report regularly to its immediate parent, Bank of Ireland, all relevant balance sheet and off-balance sheet items to ensure compliance with Bank of Ireland liquidity procedures.

The tables below summarise the maturity profile of the Bank's financial liabilities at 31 December 2018 and 2017 based on contractual undiscounted repayment obligations. The Bank does not manage liquidity risk on the basis of contractual maturity. Instead the Bank manages liquidity risk based on expected cash flows. The balances will not agree directly to the balance sheet as the tables incorporate all cash flows on an undiscounted basis related to both the principal and interest payments.

# 27 Risk management and control (continued)

| **2018** **Liabilities** | **Demand €m** | **Up to 3 months €m** | **3-12 months €m** | **1-5 years €m** | **Over 5 years €m** | **Total €m** |
|---|---|---|---|---|---|---|
| Deposits from banks | - | 1,436 | 1,320 | 6,434 | 336 | 9,526 |
| Debt securities in issue | - | 785 | 81 | 4,150 | 3,793 | 8,809 |
| Subordinated liabilities | - | - | 3 | 106 | 52 | 161 |
| Other financial liabilities | 17 | - | - | - | - | 17 |
| Loan commitments | 762 | - | - | - | - | 762 |
| **Total** | **779** | **2,221** | **1,404** | **10,690** | **4,181** | **19,275** |

| 2017 Liabilities | Demand €m | Up to 3 months €m | 3-12 months €m | 1-5 years €m | Over 5 years €m | Total €m |
|---|---|---|---|---|---|---|
| Deposits from banks | - | 2,379 | 1,373 | 4,582 | 136 | 8,470 |
| Debt securities in issue | - | 738 | 45 | 4,449 | 2,216 | 7,448 |
| Subordinated liabilities | - | - | 4 | 109 | 55 | 168 |
| Other financial liabilities | 36 | - | - | - | - | 36 |
| Loan commitments | 1,307 | - | - | - | - | 1,307 |
| Total | 1,343 | 3,117 | 1,422 | 9,140 | 2,407 | 17,429 |

Deposits from banks represent funding provided by the Group for the purposes of fixed mortgage book funding and residual variable mortgage book funding.

The table below analyses cash flows on derivative financial instruments into relevant maturity groupings based on the remaining period at the balance sheet date to the contractual maturity date. The Bank does not manage liquidity risk on the basis of contractual maturity. Instead the Bank manages liquidity risk based on expected cash flows. Cash flows associated with derivatives are undiscounted cash flows anticipated over the life of the derivatives based on expected interest rates at year end. Derivative cash flows are included for the pay and receive legs of net settled contracts with negative fair values.

| **2018** **Liabilities** | **Up to 3 months €m** | **3-12 months €m** | **1-5 years €m** | **Over 5 years €m** | **Total €m** |
|---|---|---|---|---|---|
| **Net cash outflows / (inflows) on derivative financial instruments** | **6** | **16** | **20** | **(1)** | **41** |

| 2017 Liabilities | Up to 3 months €m | 3-12 months €m | 1-5 years €m | Over 5 years €m | Total €m |
|---|---|---|---|---|---|
| Net cash outflows on derivative financial instruments | 2 | 8 | 14 | 2 | 26 |

## 27 Risk management and control (continued)

**Operational risk**
The Bank faces operational risk in the normal pursuit of its business objectives. Operational risk is defined as the risk of loss arising from inadequate or failed internal processes, people and systems or from external events. The Bank operates systems of risk identification, assessment and monitoring designed to ensure that operational risk management is consistent with the approach, aims and strategic goals of the Bank and the Group. Operational risk is managed in compliance with the Group Operational Risk policy which has been adopted by the Board of the Bank. The Bank manages operational risk through accountable executives overseen by the Bank's Audit Committee. In addition, there is oversight by the Group Operational Risk committee.

Potential risk exposures are assessed on a regular basis and appropriate controls are put in place or adapted as considered necessary. Recognising that operational risk cannot be entirely eliminated, the Bank implements risk mitigation controls including fraud prevention, contingency planning and incident management. This strategy is further supported by risk transfer mechanisms, such as insurance, where appropriate. There is a Master Service Agreement in place for the services being provided to the Bank by the Group underpinned by Service Level Agreements (SLAs) with Group service delivery units. Formal management of SLAs facilitates the identification and management of risks ensuring that services are delivered to requirements and agreed standards, as documented in the SLAs, and according to predetermined key performance indicators.

**Regulatory risk**
Regulatory risk is defined as the risk of failure to meet new or existing regulatory and / or legislative requirements and deadlines or to embed requirements into processes. It includes regulatory compliance risk and regulatory change risk and also the risk to capital, liquidity and profitability from the impact of future legislative and regulatory changes. Non-compliance would have adverse reputational implications and could lead to fines, public reprimands, enforced suspension of operations or, in extreme cases, withdrawal of authorisation to operate.

Regulatory risk in the Bank is managed in accordance with Group policy which has been adopted by the Board. This requires the conduct of business in accordance with applicable regulations and an awareness of regulatory risk by all employees.

The effective management of regulatory compliance is the responsibility of the management of the Bank. At an overall level, the Bank reassesses its regulatory risk profile on a regular basis, monitors compliance and reports findings to the Board and separately to the Group Operational Risk and Compliance function.

The Bank has no appetite to knowingly breach any of its regulatory obligations. However, it is recognised that the business will be exposed to a level of unintentional breaches that may occur in the normal course of business as a result of operational risk events in the provision of financial services.

Changes to laws and regulations present a material risk to the Bank and therefore the policy of the Bank is to implement appropriate control to minimise the risk of regulatory breaches as a result of changes in laws and regulations.

**Conduct Risk**
Conduct risk is the risk that the Bank, and / or its staff, conducts business in an inappropriate or negligent manner that leads to adverse customer outcomes.

The key conduct risk exposure areas managed by the Bank include the following:

- The risk of not delivering fair outcomes to customers:
  - The Bank has no appetite for the Bank and / or its staff conducting business in an inappropriate or negligent manner that leads to adverse outcomes for customers, colleagues, communities, (including shareholders, suppliers and regulators). To this end, the risk of systemic unfair and adverse outcomes for customers, if crystallised, would be inconsistent with the Bank Risk Appetite statement. However, it is acknowledged that there may be a certain level of risk arising from the nature of the Bank's operations e.g. staff and systems dependency, and that unintended unfair or adverse outcomes may occur.
- Risk of not delivering appropriate products and services to the market in line with appropriate governance:
  - There is no appetite for the Bank and / or its staff conducting business in an inappropriate or negligent manner that leads to adverse outcomes for customers, colleagues and communities (including shareholders, suppliers and regulators). To this end, the failure to:
  - design and develop products and services that continue to be suitable over the lifetime of the product, or
  - respond to changing customer needs[1] would be inconsistent with the Bank Risk Appetite statement. However, it is acknowledged that there may be a certain level of risk arising from the nature of the Banks operations e.g. staff and systems dependency, and that unintended unfair or adverse outcomes may occur in the product and service lifecycle, and the Bank is committed to continually reducing same.
- Risk of not implementing Bank standards of behaviour:
  - There is no appetite for the Bank and / or its staff conducting business in an inappropriate or negligent manner that leads to adverse outcomes for customers, colleagues and communities (including shareholders, suppliers and regulators). To this end, the risk of staff not meeting set standards of behaviour that has a material negative outcome for stakeholders including customers, colleagues, shareholders, suppliers, the Government and regulators, if crystallised, would be inconsistent with the Bank Risk Appetite statement. However, it is acknowledged that there may be a certain level of risk arising from people dependent-processes within the Bank e.g. where there is unintentional human error and the Bank is committed to continually reducing same.

*[1] There may be instances where the Bank will not be made aware of changing customer needs and, as such, will not be able to respond to same. In addition, there may be instances where recommendations to better serve a customer's needs may be disregarded by customers.*

## 27 Risk management and control (continued)

**Business and strategic risk**
Business risk is defined as the risk to the Bank's projected outcomes (i.e. income, net worth or reputation) which could be associated with:

- a change in the operational economics of the Bank; and / or
- exposure to an event which causes reputational damage to the Bank.

The risk may arise from a change in the competitive environment, new market entrants, new products, or a failure to anticipate or mitigate a related risk. Typically business risk is assessed over a one year timeframe and references the risk to earnings caused by changes in the above factors.

Strategic risk is defined as the risk to the Bank's projected outcomes (i.e. income, net worth or reputation) which could be associated with:

- failure to develop a strategy, leaving the Bank exposed to developments that could have been foreseen including adverse macroeconomic or market changes;
- poor execution of a chosen strategy, whatever the cause, including investments not aligned with strategic direction; and / or
- failing to realign a strategy, when one or several of the fundamental underpinning assumptions have changed, making that strategy inappropriate.

Strategic risk generally relates to a longer timeframe than business risk.

Business and strategic risk is impacted by other risks that the Bank faces that may contribute to an adverse change in the Bank's revenues and / or costs if these risks were to crystallise. Examples include funding risk (through volatility in the cost of funding), interest rate risk, operational risk, regulatory and reputation risks. Business risk is mitigated through business planning methods, such as cost base management and oversight of business plans which are informed by expectations of the external environment and the Bank's strategic priorities. The tracking of actual and regularly forecasted volumes and margins against budgeted levels is a key financial management process in the mitigation of business risk.

Strategic risk is mitigated through updates to the Board on industry developments, regular updates on the key macroeconomic environment impacting the Bank's activities, a review of the competitive environment and strategies at a divisional and business unit level.

**Reputation risk**
Reputation risk is defined as the risk to earnings or franchise value arising from adverse perception of the Bank's image on the part of customers, suppliers, counterparties, shareholders, investors, staff, legislators, regulators or partners. This risk typically materialises through a loss of business in the areas affected. Reputation is not a standalone risk but overlaps with other risk areas and may often arise as a consequence of external events or operational risk related issues. Reputation risk in the Bank is managed in accordance with Group policy which has been adopted by the Board.

**Capital management**
The objectives of the Bank's capital management policy are to at all times comply with regulatory capital requirements and to ensure that the Bank has sufficient capital to cover the risks of its business and support its strategy. The capital requirements set by the Single Supervisory Mechanism (SSM) are used by the Bank as the basis for its capital management. These requirements set the minimum regulatory capital levels which must be maintained at all times. The Bank is also required to maintain capital buffers set by the CBI. The capital buffers applicable to the Bank are the Capital Conservation Buffer (CCB) and the Countercyclical Capital Buffer (CCyB). The CCB is set at 2.5% of risk weighted assets (RWAs) and will be fully applicable from 1 January 2019 (phased at 0.675% per annum from 1 January 2016). The CCyB is currently set at 0% of relevant RWA, however, in July 2018, the CBI announced its intention to increase the CCyB in Ireland. The RoI CCyB will increase from its current level of 0% to 1.0% of relevant RWA effective from 5 July 2019. The RoI CCyB will apply to all RoI credit exposures. The Bank and the Group are committed to maintain sufficient capital to ensure that even under stressed conditions these requirements are met.

The Bank's capital includes the Bank's shareholders' funds (subject to regulatory adjustments) together with dated subordinated debt and other equity instruments. The amount of regulatory capital required to be held is determined by RWA levels. The Bank meets its objectives in terms of capital management through the holding of capital ratios above the minimum levels set by the SSM and CBI.

Capital strategy is integrated into the overall business strategy of the Bank and the Group.

## 28 Fair values of financial assets and financial liabilities

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Where possible, the Bank calculates fair value using observable market prices. Where market prices are not available fair values are determined using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis, option pricing models and other valuation techniques commonly used by market participants. To the extent possible, these valuation techniques use observable market data. Where observable data does not exist, the Bank uses estimates based on the best information available. The fair values of financial instruments are measured according to the following fair value hierarchy:

- Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.
- Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- Level 3 comprises financial assets and liabilities which are valued using techniques incorporating significant non-observable market data. Non-observable market data is not readily available in an active market due to market illiquidity or complexity of the product. These inputs are generally determined based on observable inputs of a similar nature, historic observations on the level of the input or analytical techniques.

Transfers between different levels are assessed at the end of all reporting periods.

The table below analyses the carrying amounts of the financial assets and financial liabilities by accounting treatment and by balance sheet heading. The table also shows the fair values of the Bank's financial assets and financial liabilities and their classification within the fair valuation hierarchy.

| | At fair value through profit or loss | | Cash flow hedge derivative at fair value through other comprehensive income | | | Fair value hierarchy | | | |
|---|---|---|---|---|---|---|---|---|---|
| **2018** | **Mandatorily €m** | **Fair value hedge derivative €m** | **€m** | **Held at amortised cost €m** | **Total €m** | **Level 1 €m** | **Level 2 €m** | **Level 3 €m** | **Total €m** |
| **Fair value of financial assets held at amortised cost** | | | | | | | | | |
| Loans and advances to banks (1) | - | - | - | 3,620 | 3,620 | - | 3,705 | - | 3,705 |
| Loans and advances to customers (2) | - | - | - | 15,644 | 15,644 | - | - | 15,355 | 15,355 |
| Other assets (2) | - | - | - | 2 | 2 | - | - | 2 | 2 |
| **Financial assets held at fair value** | | | | | | | | | |
| Derivative financial instruments (3) | 47 | 16 | 46 | - | 109 | - | 77 | 32 | 109 |
| Other financial assets at fair value through profit or loss (4) | 262 | - | - | - | 262 | - | - | 262 | 262 |
| | **309** | **16** | **46** | **19,266** | **19,637** | **-** | **3,782** | **15,651** | **19,433** |
| **Fair value of financial liabilities held at amortised cost** | | | | | | | | | |
| Deposits from banks (5) | - | - | - | 9,473 | 9,473 | - | 9,521 | - | 9,521 |
| Debt securities in issue (6) | - | - | - | 8,328 | 8,328 | 4,798 | 360 | 3,267 | 8,425 |
| Subordinated liabilities (6) | - | - | - | 140 | 140 | - | 140 | - | 140 |
| Other financial liabilities (5) | - | - | - | 17 | 17 | - | - | 17 | 17 |
| **Financial liabilities held at fair value** | | | | | | | | | |
| Derivative financial instruments (3) | 41 | - | - | - | 41 | - | 40 | 1 | 41 |
| | 41 | - | - | **17,958** | **17,999** | **4,798** | **10,061** | **3,285** | **18,144** |

## 28 Fair values of financial assets and financial liabilities (continued)

| 2017[1] | At fair value through profit or loss | | Cash flow hedge derivative at fair value through other comprehensive income €m | Held at amortised cost €m | Total €m | Fair value hierarchy | | | |
|---|---|---|---|---|---|---|---|---|---|
| | Held for trading €m | Fair value hedge derivative €m | | | | Level 1 €m | Level 2 €m | Level 3 €m | Total €m |
| **Financial assets not measured at fair value** | | | | | | | | | |
| Loans and advances to banks (1) | - | - | - | 1,915 | 1,915 | - | 1,995 | - | 1,995 |
| Loans and advances to customers (2) | - | - | - | 14,961 | 14,961 | - | - | 14,444 | 14,444 |
| Other assets (2) | - | - | - | 3 | 3 | - | - | 3 | 3 |
| **Financial assets measured at fair value** | | | | | | | | | |
| Derivative financial instruments (3) | 22 | 19 | 32 | - | 73 | - | 73 | - | 73 |
| | 22 | 19 | 32 | 16,879 | 16,952 | - | 2,068 | 14,447 | 16,515 |
| **Financial liabilities not measured at fair value** | | | | | | | | | |
| Deposits from banks (5) | - | - | - | 8,458 | 8,458 | - | 8,472 | - | 8,472 |
| Debt securities in issue (6) | - | - | - | 6,977 | 6,977 | 4,470 | - | 2,641 | 7,111 |
| Subordinated liabilities (6) | - | - | - | 141 | 141 | - | 141 | - | 141 |
| Other liabilities (5) | - | - | - | 36 | 36 | - | - | 36 | 36 |
| **Financial liabilities measured at fair value** | | | | | | | | | |
| Derivative financial instruments (3) | 18 | - | 7 | - | 25 | - | 25 | - | 25 |
| | 18 | - | 7 | 15,612 | 15,637 | 4,470 | 8,638 | 2,677 | 15,785 |

There were no transfers between the fair value hierarchy levels during 2017.

The following notes summarise the methods and assumptions used in estimating the fair values of financial instruments shown in the tables above:

***(1) Loans and advances to banks***

The Bank places funds with Bank of Ireland. Several different techniques are employed, as considered appropriate, in estimating the fair value of loans and advances. The carrying amount of variable rate loans is considered to be fair value. The fair value of fixed rate loans is calculated by discounting expected cash flows using market rates where practicable, or rates currently offered by other financial institutions with similar characteristics.

***(2) Loans and advances to customers at amortised cost and other assets***

Loans and advances to customers at amortised cost are carried net of provisions for impairment. The fair value of both fixed and variable rate loans and advances to customers at amortised cost is estimated using valuation techniques which include:

- The discounting of estimated future cash flows at current market rates, incorporating the impact of current credit spreads and margins. The fair value reflects both loan impairments at the balance sheet date and estimates of credit losses over the life of the loans; and
- Recent arm's length transactions in similar assets.

***(3) Derivative financial instruments***

Derivatives are carried at fair value at the balance sheet date. The fair value is based on the discounted future cash flows of these contracts.

Certain derivatives are valued using unobservable inputs relating to counterparty credit such as ECB forecast rates, which are significant to their valuation. The effect of using reasonably possible alternative assumptions in the valuation of these derivatives would be to increase their fair value by up to €1.3 million or decrease their fair value by up to €1.3 million, with a corresponding impact on the income statement. Where the impact of unobservable inputs is material to the valuation of the asset or liability, it is categorised as level 3 on the fair value hierarchy.

***(4) Other financial assets at fair value through profit or loss***

Other financial assets at fair value through profit or loss represent the Life Loan mortgage product which was offered by the Bank until 2010. Valuation policies and procedures are developed and approved by senior management to ensure that the valuation method is consistent with market practice and that the output is

[1] *The table above has not been restated for classification and measurement in accordance with IFRS 9 and is presented on an IAS 39 presentation basis.*

## 28 Fair values of financial assets and financial liabilities (continued)

reasonable. Further information on valuation of Life loans is included on page 29.

*(5) **Deposits from banks and other financial liabilities***
The carrying amount of variable rate deposits is considered to be fair value. The fair value of fixed rate deposits is calculated by discounting expected cash flows using market rates where practicable, or rates currently offered by other financial institutions with similar characteristics.

*(6) **Debt securities in issue and subordinated liabilities***
The fair values of these instruments are calculated based on quoted market prices in an active market where available. For those notes, where quoted market prices in an active market are not available, a discounted cash flow model is used based on a current yield curve appropriate to the Bank for the remaining term to maturity. The yield curve used incorporates the effect of changes in the Bank's own credit spread.

On transition to IFRS 9, Life Loans were reclassified from loans and advances to customers at amortised cost, to other financial assets at fair value through profit or loss. They are considered to be level 3 assets on the fair value hierarchy.

The table below shows the movement in level 3 assets and liabilities measured at fair value during 2018. Prior year figures have not been restated.

| 2018 | Derivative financial instruments €m | Other financial assets at FVTPL €m | Total €m |
|---|---|---|---|
| **Movement in level 3 assets measured at fair value** | | | |
| Opening balance | - | - | - |
| Impact of adopting IFRS 9 at 1 January 2018 | - | 270 | 270 |
| **Opening balance at 1 January 2018** | **-** | **270** | **270** |
| Net trading income | - | 15 | 15 |
| Additions | 26 | - | 26 |
| Repayments | - | (23) | (23) |
| Transfers from level 2 | 6 | - | 6 |
| **Closing balance** | **32** | **262** | **294** |
| Unrealised gain at year end | 30 | 14 | 44 |
| **Movement in level 3 liabilities measured at fair value** | | | |
| Opening balance | - | - | - |
| Transfers from level 2 | 1 | - | 1 |
| **Closing balance** | **1** | **-** | **1** |
| Unrealised gain at year end | 7 | - | 7 |

The transfers from level 2 to level 3 arose as a result of the unobservable inputs becoming significant to the fair value measurement of these liabilities.

**Quantitative information about fair value measurements using significant unobservable inputs (Level 3)**

| Level 3 assets | Valuation technique | Unobservable input | Fair value 2018 €m | Range 2018 % |
|---|---|---|---|---|
| Other financial assets at fair value through profit or loss | Discounted cash flow | Discount on market rate | 262 | 2.75%-4.5% |
| | Collateral values | Collateral changes | | 1.5%-7.5% |
| Derivative financial assets and liabilities | Discounted cash flow | ECB forecast rates 2021-2043 | 32 asset / 1 liability | 0.02%-1.22% |

## 29 Contingent liabilities and commitments

The Bank has €0.8 billion of approved mortgage loan applications that had not been drawn down at 31 December 2018 (2017: €1.3 billion). Loss allowance provisions of €88,000 recognised on mortgage loan commitments are shown in note 21.

| | 2018 | 2017 |
|---|---|---|
| Loan commitments (€bn) | 0.8 | 1.3 |
| Loss allowance provision on loan commitments (€'000) | 88 | - |

From 1 January 2018 loan commitments have been classified and measured in accordance with IFRS 9. This involved measuring the loss allowance provision for loan commitments on a 12 month or lifetime expected credit loss approach. The associated reversal of impairment has been included in the income statement as part of net impairment gains on financial instruments. See note 21 for further information.

Prior to adoption of IFRS 9, loan commitments were measured in accordance with IAS 37 at €nil. Prior year comparatives have not been restated.

## 30 Related party transactions

Bank of Ireland Mortgage Bank is a public unlimited company, incorporated and domiciled in Ireland. The Bank's immediate parent undertaking is The Governor and Company of the Bank of Ireland, a corporation established in Ireland.

The Bank's ultimate parent undertaking, and controlling party, is Bank of Ireland Group plc, a public limited company incorporated and registered in Ireland. Copies of the consolidated financial statements of the Group for 2018 are available at the Bank of Ireland, Head Office, 40 Mespil Road, Dublin 4.

**(a) Irish Government**

The Bank considers that the State is a related party under IAS 24 as it is in a position to exercise significant influence over the Group.

- *Ordinary Shares*
  At 31 December 2018, the State held, through the Ireland Strategic Investment Fund, 13.95% of the ordinary shares of Bank of Ireland Group plc (2017: 13.95%).

- *Guarantee Schemes*
  The Credit Institutions (Eligible Liabilities Guarantee) Scheme 2009 ('ELG Scheme') ended for all new liabilities on 28 March 2013.

  Although the Bank has no guaranteed liabilities under the ELG Scheme, that scheme shall continue to exist until terminated by the Minister for Finance. Pending that termination, the Bank continues to be bound by the terms of the ELG Scheme including the provision of certain covenants and an indemnity for the costs of the ELG Scheme in favour of the Minister pursuant to the Scheme documents of the ELG Scheme. No fees were payable in respect of 2018 (2017: €nil).

**(b) Transactions with Directors and Key Management Personnel**

*(i) Loans to Directors*

The information in the table below is presented in accordance with the Companies Act 2014.

For the purposes of the Companies Act disclosures, 'Directors' means the Board of Directors of the Bank, any past Directors who were Directors during the relevant period and Directors of the parent companies, The Governor and Company of the Bank of Ireland and its parent Bank of Ireland Group plc.

Directors' emoluments are provided within this note. The Bank has availed of the exemption under FRS 101 not to disclose key management personnel remuneration.

## 30 Related party transactions (continued)

| **2018**<br>**Companies Act Disclosures**<br>**Loans - Mortgages** | **Balance at 1 January 2018[1]**<br>**€'000** | **Balance at 31 December 2018[1]**<br>**€'000** | **Aggregate maximum amount outstanding during the year ended 31 December 2018[2]**<br>**€'000** | **Repayments[3] during the year ended 31 December 2018**<br>**€'000** |
|---|---|---|---|---|
| **Directors at 31 December 2018** | | | | |
| N Corcoran | 432 | 416 | 431 | 32 |
| T McMahon | 434 | 407 | 434 | 31 |
| J O'Beirne | 1,290 | 1,256 | 1,289 | 62 |
| **Directors no longer in office at 31 December 2018** | | | | |
| S Mason | 1,102 | 1,049 | 1,102 | 61 |
| L McLoughlin | 322 | 316 | 321 | 20 |

During 2018, S Crowe, G Kelly, H Lorton and R Milliken had no loans with the Bank. No advances were made during the year. No amounts were waived during the year. None of the loans above are considered to be credit-impaired.

| 2017<br>Companies Act Disclosures<br>Loans - Mortgages | Balance at 1 January 2017[1]<br>€'000 | Balance at 31 December 2017[1]<br>€'000 | Aggregate maximum amount outstanding during the year ended 31 December 2017[2]<br>€'000 | Repayments[3] during the year ended 31 December 2017<br>€'000 |
|---|---|---|---|---|
| Directors at 31 December 2017 | | | | |
| N Corcoran | 447 | 432 | 447 | 33 |
| S Mason | 1,155 | 1,102 | 1,155 | 61 |
| L McLoughlin | 326 | 322 | 326 | 18 |
| J O'Beirne | 1,321 | 1,290 | 1,320 | 64 |
| Directors no longer in office at 31 December 2017 | | | | |
| D Buckley | 569 | 556 | 568 | 31 |

S Crowe, G Kelly, H Lorton and R Milliken had no loans with the Bank during 2017. No advances were made during 2017. No amounts were waived during 2017.

There were no specific provisions or expenses in respect of any failure or anticipated failure to repay any of the above loans or interest thereon. There was no interest which having fallen due on the above loans had not been paid.

Other than as indicated, all loans to Directors are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for similar transactions with other persons unconnected with the Bank and of similar financial standing and do not involve more than the normal risk of collectability.

Loans relate to mortgages secured on residential property.

The value of arrangements at the beginning and end of each financial year as stated in the tables above, in accordance with Section 307 of the Companies Act 2014, expressed as a percentage of the net assets of the Bank at the beginning and end of the financial year is less than 1%.

*[1] Balances include principal and interest.*
*[2] The maximum amount outstanding was calculated using the highest balance on each account. While the maximum amounts do not include interest accrued, interest accrued is included in the closing balances.*
*[3] Repayments include principal and interest.*

## 30 Related party transactions (continued)

*(ii) Loans to Directors of parent companies[1] - Companies Act Disclosures*

| **2018**<br>**Directors of parent companies[1]**<br>**Loans - Mortgages** | **Balance at 1 January 2018[2]**<br>**€'000** | **Balance at 31 December 2018[2]**<br>**€'000** | **Aggregate maximum amount outstanding during the year ended 31 December 2018[3]**<br>**€'000** | **Repayments[4] during the year ended 31 December 2018**<br>**€'000** |
|---|---|---|---|---|
| **Directors at 31 December 2018** | | | | |
| P Kennedy | 2,823 | - | 2,822 | 2,829 |
| F McDonagh | - | 981 | 986 | 14 |
| F Muldoon | 135 | 103 | 134 | 36 |
| **Directors no longer in office at 31 December 2018** | | | | |
| None | - | - | - | - |

| 2017<br>Directors of parent companies[1]<br>Loans - Mortgages | Balance at 1 January 2017[2]<br>€'000 | Balance at 31 December 2017[2]<br>€'000 | Aggregate maximum amount outstanding during the year ended 31 December 2017[3]<br>€'000 | Repayments[4] during the year ended 31 December 2017<br>€'000 |
|---|---|---|---|---|
| Directors at 31 December 2017 | | | | |
| P Kennedy | 2,823 | 2,823 | 2,822 | 17 |
| F Muldoon | 165 | 135 | 165 | 36 |
| Directors no longer in office at 31 December 2017 | | | | |
| R Boucher | 16 | - | 16 | 16 |

K Atkinson, E Bourke, I Buchanan, R Goulding, P Haren, A Kane, A Keating, D Marston, P Mulvihill and S Pateman had no loans with the Bank during 2018. Advances totalling €985,000 were made to F McDonagh during 2018. No amounts were waived during 2018.

K Atkinson, P Butler, T Considine, R Goulding, P Haren, A Kane, A Keating, D Marston, B Martin, F McDonagh and P Mulvihill had no loans with the Bank during 2017. F McDonagh had a mortgage facility for €985,000 approved during 2017, which was not drawn down. No advances were made during 2017 to any directors of the parent company. No amounts were waived during 2017.

None of the loans above are considered to be credit-impaired. There is no interest which having fallen due on the above loans has not been paid.

Other than as indicated, all loans to Directors are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for similar transactions with other persons unconnected with the Bank and of similar financial standing and do not involve more than the normal risk of collectability.

Loans relate to mortgages secured on residential property.

The value of arrangements at the beginning and end of each financial year as stated in the tables above, in accordance with Section 307 of the Companies Act 2014, expressed as a percentage of the net assets of the Bank at the beginning and end of the financial year is less than 1%.

*(iii) Loans to connected persons on favourable terms*

There were no loans to connected persons required to be disclosed as at 31 December 2018 or 2017.

*(iv) Loans to connected persons - Central Bank of Ireland licence condition disclosures*

Connected persons of Directors are defined by Section 220 of the Companies Act 2014. All loans to connected persons are made in the ordinary course of business on substantially the same terms, including interest rates and collateral, as those prevailing at the time for similar transactions with other persons and, except in the case of one loan to a connected person of T McMahon (€157,000), do not involve more than the normal risk of collectability.

*1 Parent companies at 31 December 2018 and 2017 are The Governor and Company of the Bank of Ireland and its parent Bank of Ireland Group plc.*
*2 Balances include principal and interest.*
*3 The maximum amount outstanding was calculated using the highest balance on each account. While the maximum amounts do not include interest accrued, interest accrued is included in the closing balances.*
*4 Repayments include principal and interest.*

## 30 Related party transactions (continued)

Under its banking licence, the Bank is required to disclose in its annual audited financial statements details of:
- the aggregate amount of lending to all connected persons, as defined in Section 220 of the Companies Act 2014; and
- the aggregate maximum amount outstanding during the period for which those financial statements are being prepared.

Disclosure is subject to certain de-minimis exemptions and to exemptions for loans relating to principal private residences where the total of such loans to an individual connected person does not exceed €1 million.

The following information is presented in accordance with this licence condition.

There were no loans to connected persons required to be disclosed as at 31 December 2017.

| **2018**<br>**Connected persons of the following Director** | **Balance at 31 December 2018 €'000** | **Aggregate maximum amount outstanding during the year ended 31 December 2018 €'000** | **Number of persons as at 31 December 2018** | **Maximum number of persons during the year ended 31 December 2018** |
|---|---|---|---|---|
| T McMahon | 1,775 | 2,239 | 1 | 1 |

*(v) Key management personnel (KMP) - loans*

The information in the table below is prepared in accordance with IAS 24: Related Party Disclosures.

For the purposes of IAS 24: Related Party Disclosures, key management personnel (KMP) comprise the Directors of the Bank and key management personnel ('Head of Mortgage and Consumer Credit RoI', 'Divisional Finance Officer,' 'CEO Markets & Treasury', 'Chief Risk Officer', 'Director of Products', 'Head of Mortgages RoI' and 'Head of Challenged Assets Group'). Key management personnel also comprise KMP of the parent companies, The Governor and Company of the Bank of Ireland and its parent Bank of Ireland Group plc.

Key management personnel including Directors hold mortgages with the Bank in the ordinary course of business. All loans to Non-executive Directors are made in the ordinary course of business on normal commercial terms. Loans to key management personnel other than Non-executive Directors are made on terms similar to those available to staff generally and / or in the ordinary course of business on normal commercial terms.

The aggregate amounts outstanding, in respect of all loans, quasi-loans and credit transactions between the Bank, its key management personnel as defined above, including members of their close families and entities influenced by them, and key management personnel of the parent companies as noted above, are shown in the following table.

| **2018**<br>**IAS 24 Disclosures Key Management Personnel** | **Balance at 1 January 2018[1] €'000** | **Balance at 31 December 2018[1] €'000** | **Maximum amounts outstanding during the year ended 31 December 2018[2] €'000** | **Number of KMP as at 1 January 2018** | **Number of KMP as at 31 December 2018** |
|---|---|---|---|---|---|
| Loans[3] | 11,249 | 11,155 | 14,977 | 18 | 19 |

| 2017<br>IAS 24 Disclosures Key Management Personnel | Balance at 1 January 2017[1] €'000 | Balance at 31 December 2017[1] €'000 | Maximum amounts outstanding during the year ended 31 December 2017[2] €'000 | Number of KMP as at 1 January 2017 | Number of KMP as at 31 December 2017 |
|---|---|---|---|---|---|
| Loans[3] | 10,624 | 11,249 | 12,044 | 17 | 18 |

Loans relate to mortgages secured on residential property.

[1] *Balances include principal and interest.*
[2] *The maximum amount outstanding during the year is calculated using the highest balance on each account. The highest maximum outstanding liability in respect of a loan or mortgage during 2018 for any member of KMP and their close family did not exceed €2.8 million (2017: €2.8 million). While the maximum amounts do not include interest accrued, interest accrued is included in the closing balance.*
[3] *The opening balance includes balances and transactions with KMP who have retired during 2018 and are not related parties during the current year. Therefore these KMP are not included in the maximum amounts outstanding.*

## 30 Related party transactions (continued)

The IAS 24 loan disclosure above includes loans to key management personnel on preferential staff rates amounting to €0.41 million (2017: €0.43 million). Save as referred to in sub-section (iv) above, none of the loans in sub-section (i) to (v), are considered to be credit-impaired and there is no interest which having fallen due on the above loans has not been paid.

There are no guarantees entered into by the Bank in favour of KMP of the Bank and no guarantees in favour of the Bank have been entered into by the KMP of the Bank.

(vi) *Directors' remuneration*
No other fees or bonuses were paid to Directors during 2018 (2017: €nil).

| | 2018 €'000 | 2017 €'000 |
|---|---|---|
| Fees | 125 | 125 |
| Other emoluments | 181 | 215 |
| Other - pension | 32 | 36 |
| Other - termination benefits | 79 | - |
| **Total remuneration** | **417** | **376** |

## 31 IAS 39 to IFRS 9 transitional disclosures

The basis of classification of financial assets under IFRS 9 depends on the entity's business model and the contractual cash flow characteristics of the financial asset.

In order to be accounted for at amortised cost or FVOCI, it is necessary for individual instruments to have contractual cash flows that are solely payments of principal and interest (SPPI). Life Loans which were classified as loans and receivables have been mandatorily classified at fair value through profit or loss (FVTPL) under IFRS 9 as they do not have contractual cash flows that are SPPI.

The following table provides a reconciliation of the classification of financial assets and liabilities from IAS 39 to IFRS 9 on the date of initial application of IFRS 9.

| 2018 | Note | Classification under IAS 39 | Classification under IFRS 9 | Carrying amount under IAS 39 31 December 2017 €m | Carrying amount under IFRS 9 1 January 2018 €m |
|---|---|---|---|---|---|
| **Financial assets** | | | | | |
| Derivative financial instruments | 11 | FVTPL | FVTPL (mandatory) | 73 | 73 |
| Other financial assets at FVTPL | 12 | Loans and receivables | FVTPL (mandatory) | - | 270 |
| Loans and advances to banks | 13 | Loans and receivables | Amortised cost | 1,915 | 1,914 |
| Loans and advances to customers at amortised cost | 14 | Loans and receivables | Amortised cost | 14,961 | 14,733 |
| Other assets | | Loans and receivables | Amortised cost | 3 | 3 |
| **Total financial assets** | | | | **16,952** | **16,993** |
| **Financial liabilities** | | | | | |
| Deposits from banks | 17 | Amortised cost | Amortised cost | 8,458 | 8,458 |
| Debt securities in issue | 18 | Amortised cost | Amortised cost | 6,977 | 6,977 |
| Subordinated liabilities | 22 | Amortised cost | Amortised cost | 141 | 141 |
| Other liabilities | 19 | Amortised cost | Amortised cost | 36 | 36 |
| Derivative financial instruments | 11 | FVTPL | FVTPL (mandatory) | 25 | 25 |
| Loss allowance provision on loan commitments | 21 | Amortised cost | Amortised cost | - | - |
| **Total financial liabilities** | | | | **15,637** | **15,637** |

## 31 IAS 39 to IFRS 9 transitional disclosures (continued)

The following table provides a reconciliation of the Bank's balance sheet by measurement category from IAS 39 to IFRS 9 at 1 January 2018.

| | Carrying amount under IAS 39 31 December 2017 €m | Reclassification €m | Remeasurement €m | Carrying amount under IFRS 9 1 January 2018 €m |
|---|---|---|---|---|
| **Financial assets at amortised cost** | | | | |
| **Loans and advances to banks** | | | | |
| Opening balance | 1,915 | - | - | 1,915 |
| Remeasurement | - | - | (1) | (1) |
| **Total loans and advances to banks** | **1,915** | **-** | **(1)** | **1,914** |
| **Loans and advances to customers at amortised cost** | | | | |
| Opening balance | 14,961 | - | - | 14,961 |
| To loans and advances to customers at fair value through profit or loss[1] | - | (295) | - | (295) |
| Remeasurement | - | - | 67 | 67 |
| **Total loans and advances to customers at amortised cost** | **14,961** | **(295)** | **67** | **14,733** |
| **Other assets** | | | | |
| Opening balance | 3 | - | - | 3 |
| Remeasurement | - | - | - | - |
| **Total other assets** | **3** | **-** | **-** | **3** |
| **Financial assets at fair value through profit or loss** | | | | |
| **Derivative financial instruments** | **73** | **-** | **-** | **73** |
| **Loans and advances to customers mandatorily at fair value through profit or loss** | | | | |
| Opening balance | - | - | - | - |
| From loans and advances to customers at amortised cost | - | 295 | - | 295 |
| Remeasurement[2] | - | - | (25) | (25) |
| **Total loans and advances to customers mandatorily at fair value through profit or loss** | **-** | **295** | **(25)** | **270** |
| **Other assets at fair value through profit or loss** | **73** | **295** | **(25)** | **343** |
| **Deferred tax asset** | | | | |
| Opening balance | 34 | - | - | 34 |
| Tax on impairment loss allowance - remeasurement | - | - | (5) | (5) |
| **Total deferred tax asset** | **34** | **-** | **(5)** | **29** |
| Current tax asset | 13 | - | - | 13 |
| **Total assets** | **16,999** | **-** | **36** | **17,035** |

[1] *Loans and advances to customers that fail the solely payment of principal and interest (SPPI) test are mandatorily measured at fair value through profit or loss.*

[2] *The carrying amount of loans and advances to customers reclassified to financial assets at fair value through profit or loss will have had an impairment provision under IAS 39. Financial assets at fair value through profit or loss are not subject to impairment under IFRS 9.*

## 31 IAS 39 to IFRS 9 transitional disclosures (continued)

| | Carrying amount under IAS 39 31 December 2017 €m | Reclassification €m | Remeasurement €m | Carrying amount under IFRS 9 1 January 2018 €m |
|---|---|---|---|---|
| **Financial liabilities at amortised cost** | | | | |
| Deposits from banks | 8,458 | - | - | 8,458 |
| Debt securities in issue | 6,977 | - | - | 6,977 |
| Subordinated liabilities | 141 | - | - | 141 |
| Other liabilities | 36 | - | - | 36 |
| **Total financial liabilities at amortised cost** | **15,612** | **-** | **-** | **15,612** |
| **Loss allowance provision on loan commitments** | | | | |
| Opening balance | - | - | - | - |
| Remeasurement[1] | - | - | - | - |
| **Total loss allowance provision on loan commitments** | **-** | **-** | **-** | **-** |
| **Financial liabilities at fair value through profit or loss** | | | | |
| Derivative financial instruments | 25 | - | - | 25 |
| **Total financial liabilities at fair value through profit or loss** | **25** | **-** | **-** | **25** |
| Provisions | 123 | - | - | 123 |
| **Non-financial liabilities** | **123** | **-** | **-** | **123** |
| **Total liabilities** | **15,760** | **-** | **-** | **15,760** |
| **Retained earnings** | | | | |
| Opening balance | (376) | | - | (376) |
| Remeasurement (after tax) | - | - | 36 | 36 |
| **Total impact on retained earnings** | **(376)** | **-** | **36** | **(340)** |

[1] *The loss allowance provision on loan commitments was €0.1 million. See note 21 for further details.*

## 31 IAS 39 to IFRS 9 transitional disclosures (continued)

| | Provision under IAS 39 IAS 37 31 December 2017 €m | Reclassification €m | Remeasurement €m | Loss allowance under IFRS 9 1 January 2018 €m |
|---|---|---|---|---|
| **Financial assets at amortised cost** | | | | |
| Opening balance | 464 | - | - | 464 |
| Remeasurement | - | - | (54) | (54) |
| **Total assets at amortised cost** | **464** | **-** | **(54)** | **410** |
| **Total impairment loss allowance** | **464** | **-** | **(54)** | **410** |
| **Provisions** | | | | |
| Loan commitments[1] | - | - | - | - |
| **Total loss allowance provision on loan commitments** | **-** | **-** | **-** | **-** |

## 32 Post balance sheet events

On 10 January 2019, the ECB approved a reduction of €250 million of ordinary share capital in the Bank by means of the cancellation of 250 million of ordinary shares at par of €1 each. The Bank has a significant capital surplus above its risk appetite and its regulatory requirements which is not efficient and has a negative impact on Return on Total Equity. The capital reduction results in a distribution of €250 million to its immediate parent company, the Governor and Company of the Bank of Ireland and reduces CET 1 capital in the Bank by c. 4%. Following the reduction in share capital, the Bank will continue to have an adequate surplus over risk appetite and regulatory requirements. The reduction in share capital and distribution to the immediate parent was completed in January 2019.

## 33 Approval of the financial statements

The Directors approved these financial statements on 22 February 2019.

[1] *The loss allowance provision on loan commitments was €0.1 million. See note 21 for further details.*

# Glossary

**Further information related to certain measures referred to in this Report**

**Cure rate** is a rate used in ECL calculation which reflects that a portion of loans entering default will exit default with no loss realised.

**Forborne collateral realisation** loans (FCRs) that are not greater than 90 days past due and / or impaired consist of loans where forbearance is in place and where future reliance on the realisation of collateral is expected, for the repayment in full of the relevant borrower loan. Such arrangements will include Split Mortgages and certain 'Interest Only' / 'Interest Only plus' arrangements.

'**Non-performing exposures**' (NPEs) consist of:

(i) credit-impaired loans which includes loans where the borrower is considered unlikely to pay in full without recourse by the Bank to actions such as realising security, including FCR cases, and loans where the borrower is greater than 90 days past due and the arrears amount is material; and

(ii) other / probationary loans that have yet to satisfy exit criteria in line with EBA guidance to return to performing.

**Principal employer** is the Governor and Company of the Bank of Ireland.

**Return on assets** is calculated as being statutory net profit (being profit after tax) divided by total assets, in line with the requirement in the European Union (Capital Requirements) Regulations 2014.

**The Group** is the Bank of Ireland Group plc and its subsidiary undertakings.

**Underlying net interest income** is net interest income excluding the impact of the Tracker Mortgage Examination Review and comprises underlying interest income less interest expense.

# Abbreviations

| | |
|---|---|
| **ACS** | Asset Covered Securites |
| **AT1** | Additional tier 1 |
| **Bank** | Bank of Ireland Mortgage Bank |
| **BIGPF** | Bank of Ireland Group Pension Fund |
| **BPFI** | Banking and Payments Federation Ireland |
| **CBI** | Central Bank of Ireland |
| **CCB** | Capital Conservation Buffer |
| **CCyB** | Countercyclical buffer |
| **CET 1** | Common equity tier 1 |
| **CRR** | Capital Requirements Regulation |
| **CSO** | Central Statistics Office |
| **DCF** | Discounted Cash Flow |
| **EAD** | Exposure at Default |
| **EBA** | European Banking Authority |
| **ECB** | European Central Bank |
| **ECL** | Expected credit losses |
| **EIR** | Effective Interest Rate |
| **ELG** | Eligible Liabilities Guarantee Scheme |
| **EU** | European Union |
| **EURIBOR** | Euro InterBank Offered Rate |
| **FCR** | Forborne collateral realisation |
| **FLI** | Forward looking information |
| **FRS 101** | Financial Reporting Standard 101 |
| **FVOCI** | Fair Value through Other Comprehensive Income |
| **FVTPL** | Fair Value Through Profit or Loss |
| **GDP** | Gross Domestic Product |
| **GRPC** | Group Risk Policy Committee |
| **IAASA** | Irish Auditing and Accounting Supervisory Authority |
| **IAS** | International Accounting Standard |
| **IBNR** | Incurred but not Reported |
| **ICS PP** | ICS Building Society Pension Plan |
| **IFRS** | International Financial Reporting Standard |
| **IRB** | Internal Rating Based |
| **ISAs** | International Standards on Auditing |
| **KMP** | Key management personnel |
| **LGD** | Loss Given Default |
| **LTV** | Loan to Value |
| **MRO** | Main Refinancing Operations |
| **NII** | Net interest income |
| **NPEs** | Non-performing exposures |
| **OCI** | Other Comprehensive Income |
| **PD** | Probability of Default |
| **POCI** | Purchased or Originated Credit-Impaired |
| **RMC** | Risk Measurement Committee |
| **RoI** | Republic of Ireland |
| **RPPI** | Residential Property Price Index |
| **RWAs** | Risk weighted assets |
| **SICR** | Significant Increase in Credit Risk |
| **SLAs** | Service Level Agreements |
| **SPPI** | Solely Payment of Principal and Interest |
| **SSM** | Single Supervisory Mechanism |
| **TLTRO** | Targeted Longer-Term Refinancing Operations |
| **TME** | Tracker Mortgage Examination |
| **TRIM** | Targeted Review of Internal Models |
| **UK** | United Kingdom |
| **VAT** | Value added tax |