

**directors' report**  
and financial statements

**2005**

DEPFA ACS BANK

 **DEPFA BANK**  
DEPFA ACS BANK

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# Directors and Other Information

## Board of Directors

Mr. B. Heide-Ottosen (Chairman, appointed 26th October 2005)  
Mr. D. M. Cahillane (Chairman, resigned 26th October 2005)  
Dr. T. P. Carey  
Mr. M. Deeny  
Mr. B. Farrell  
Ms. J. Hoggett  
Prof. Dr. F. Ruane

## Solicitors

McCann Fitzgerald  
2 Harbourmaster Place  
Custom House Dock  
Dublin 1  
Ireland

## Audit Committee

Prof. Dr. F. Ruane (Chairperson)  
Mr. D. M. Cahillane (resigned 26th October 2005)  
Dr. T. P. Carey

## Secretary & Registered Office

Mr. N. J. Kavanagh (resigned 11th April 2006)  
Ms. E. Tiernan (appointed 12th April 2006)  
1 Commons Street  
Dublin 1  
Ireland

## Auditors

PricewaterhouseCoopers  
Chartered Accountants and Registered  
Auditors  
George's Quay  
Dublin 2  
Ireland

## Cover Assets Monitor

AIB International Financial Services Ltd  
AIB International Centre  
Dublin 1  
Ireland

## Registered Number

354382

# Directors' Report

The directors present herewith the audited financial statements for the year ended 31 December 2005.

## Statement of Directors' responsibilities

The directors are responsible for preparing the Annual Report and the financial statements of DEPFA ACS BANK ("the Bank") in accordance with International Financial Reporting Standards ("IFRS") and IFRIC interpretations endorsed by the European Union, and with those parts of the Companies Acts, 1963 to 2005 applicable to companies reporting under IFRS and the European Communities (Credit Institutions: Accounts) Regulations, 1992.

Irish company law requires the directors to prepare financial statements for each financial year which give a true and fair view of the state of affairs of the company and of the profit or loss of the company for that period. In preparing these financial statements, the directors are required to:

- select suitable accounting policies and then apply them consistently;
- make judgments and estimates that are reasonable and prudent;
- state that the financial statements comply with IFRS as adopted by the European Union,
- prepare the financial statements on the going concern basis unless it is inappropriate to presume that the group will continue in business.

The directors confirm that they have complied with the above requirements in preparing the financial statements.

The directors are responsible for keeping proper books of account that disclose with reasonable accuracy at any time the financial position of the company and enable them to ensure that the financial statements are prepared in accordance with IFRS and IFRIC interpretations endorsed by the European Union, with those parts of the Companies Act, 1963 to 2005 applicable to companies reporting under IFRS and the European Communities (Credit Institutions: Accounts) Regulations, 1992.

## Principal activities

The Bank's primary activity is the issuance of covered bonds under the Asset Covered Securities Act ("the Legislation") enacted in 2001. These fixed or floating rate instruments are covered by a pool of assets, which include mandatory over-collateralisation assets, all of which are public sector and primarily located in member countries of the European Economic Association (EEA), and relevant derivatives. The Bank generates public sector assets primarily through its parent to support these activities. The Bank has a full banking licence and is a designated credit institution (DCI) as defined in the Legislation. The Bank is regulated by the Irish Financial Services Regulatory Authority (IFSRA).

## Accounting records

The Directors have taken appropriate measures to secure compliance with the Bank's obligation to keep proper books of account through the use of appropriate systems and procedures and employment of competent persons. The books of account are kept at 1 Commons Street, IFSC, Dublin 1, Ireland.

## Review of business and future development

The Bank recorded a large increase in revenues in 2005, with total operating income almost doubling from € 44.95 million in 2004 to € 89.56 million in 2005.

This increase consisted primarily of a 23% increase in net interest income to € 56.13 million, compared with € 45.51 million in 2004, as well as income from sales of financial assets of € 25.86 million, compared with € 0.95 million in 2004. The increase in net interest income was derived primarily from the asset base of the Bank, which grew from € 39.99 billion at year-end 2004 to € 58.32 billion at year-end 2005, an increase of 46%. The increase in income from sales of financial assets resulted from the Bank taking advantage of favourable market conditions.

The other main component of the increase in total operating income was net trading income, which recorded a profit of € 6.89 million in 2005, versus a deficit of € 1.52 million in the prior year. This result derives mainly from the hedging of assets and liabilities by certain derivative instruments, as well as gains and losses on foreign exchange transactions.

On the expenses side, total operating expenses fell by 8%, from € 9.49 million in 2004 to € 8.75 million in 2005. Personnel costs rose by 62% as a result of increased staffing numbers, from € 1.32 million in 2004 to € 2.15 million in 2005. Administration costs rose by 65% from € 1.27 million in 2004 to € 2.10 million in 2005. However, these increases were offset by a reduction of 35% in recharged expenses from other DEPFA Group companies, from € 6.89 million in 2004 to € 4.51 million in 2005.

The aim of the directors in 2005 was to build on the momentum established in the previous two years of issuance by diversifying the Bank's funding base. This was achieved through the expansion of both the product range and investor base. The continued growth and diversification of the Bank's funding operations in 2005 on both the international capital and money markets reflects the achievement of this goal.

The results in 2005 were underpinned by the Banks' benchmark programme - an annual commitment to issue in the ACS market. In 2005, the Bank issued a total of € 3 billion and USD 2.25 billion in benchmark transactions. Firstly, € 3 billion was issued in January 2005 which was the Bank's first bond in benchmark format with a 7-year maturity. This was followed by a USD 1.25 billion 5-year benchmark issued in May 2005 and a USD 1 billion 10-year benchmark issued in October 2005, which was the first 10-year USD covered bond benchmark issue by any bank. These transactions represented the Bank's first USD benchmarks following its inaugural USD benchmark issued in October 2003. The issue of the two USD benchmarks completed the Bank's USD curve with the Bank now having outstanding maturities in 2008, 2010 and 2015.

During the course of the Bank's 2005 benchmark transactions, orders were received from 113 new investors bringing the total number of different investors to over 450 since the first benchmark transaction in 2003.

Apart from its benchmark programme, the Bank has also successfully diversified its funding sources through issuance from its Euro Medium Term Note ("EMTN") programme. The Bank has now raised a total of € 12.2 billion since the inception of its EMTN activities with € 7.65 billion of this raised in 2005 through a range of different structures. Issuance was completed in a wide range of currencies, including Euro, US Dollar, British Pound, Swiss Franc, Canadian Dollar, Australian Dollar, Swedish Krona, Norwegian Kroner, Hong Kong Dollar, and Singapore Dollar. The range of different currencies largely reflects the diversity of the assets in the cover pool of the Bank.

In addition to the EMTN activities, a further € 2.5 billion was issued in registered format since developing the requisite documentation in April 2004. These transactions are most commonly placed with German insurance companies and are typically attractively-priced long term issues which enhance the Bank's access to the 15 to 30 year maturities.

The Bank further enhanced its reputation in the international Money Markets in 2005, through its wholesale deposit activities, bilateral repurchase operations, and central bank activities with the European Central Bank. Continuous efforts are made to raise the Bank's profile in the European Money Markets, as well as in the UK and the Nordic region. The Bank continues to pursue signing ISDA Master Agreements with major financial institutions, allowing the Bank to transact in the global derivative and foreign exchange markets.

In 2006, the Bank will look to benefit from its highly regarded franchise as one of the premier European issuers of short term securities. The Bank avails of the highest possible short term ratings from the three main rating agencies, and has become an active participant in the international financial markets. It is anticipated that further product diversification and increased funding sources will follow as credit lines are established with new counterparties.

In conjunction with the growth in issuance of liability products, the asset base of the Bank experienced significant growth in 2005. The Legislation contains a range of eligibility criteria for assets held in the cover pool, which the Bank ensures are complied with. The overall aim is to underpin the AAA rating attaching to the covered bonds by maintaining a cover pool consisting of a diversified range of assets with high quality average credit ratings and risk weightings. New assets are originated primarily by the business development teams of the DEPFA BANK Group ("the Group").

In conclusion, 2005 was a successful year for the Bank. It is anticipated that the Bank will maintain its leading position in the Irish ACS market in the years ahead.

## **Results**

The profit for the year, and the appropriation thereof, are set out in the income statement on page 12.

## **Dividends**

The directors propose a dividend of € 71,034,529 in respect of the year ended 31 December 2005. A dividend of € 49,912,823 was paid in 2005 in respect of the year ended 31 December 2004.

## **Directors**

The names of the persons who were directors at any time during the year ended 31 December 2005 are listed on page 2.

## **Measurement and management of the various types of risk**

In accordance with Group requirements, the Bank applies Group policies and procedures to the management of credit risk, market risk, operational risk and liquidity risk. The following is an overview of these policies and procedures.

## Credit risk

Credit Risk is the risk of impairment and partial or total loss of a receivable due to deterioration of credit quality on the part of a counterparty. The relevant receivable may be based on traditional on-balance sheet lending business or derivative business.

Whereas in traditional lending business, risk arises from the creditworthiness of the borrower and the value of the collateral, derivative counterparty risk results from the counterparty's failure to perform the transaction in accordance with contractual obligations, leading to a loss when executing a substitute transaction in the market at less favourable terms.

The Bank's business is focused on sovereign and sub-sovereign borrowers and public sector supported specialist entities.

### Assessing credit risk – the internal rating system in the DEPFA BANK Group

Credit scoring of counterparties is critical to the Bank's business. The Bank applies the Group credit model. The scoring model of the Group is reviewed continuously. In recent years, the Group moved to a unitary scoring system for its four main credit risk pools (sovereign, sub-sovereign, financial institutions and infrastructure finance). The unitary scoring has 22 grades. The Group's 22-grade internal rating system is similar to the grading system used by the External Credit Assessment Institutions ("ECAI"). All counterparties across all risk groups are graded in accordance with this system. The rated clients and counterparties account for a very high proportion of the Bank's assets (82.75%). 25.64% of the portfolio of on-balance sheet interest earning assets relates to counterparties with triple-A ratings by ECAs while a further 45.48% of assets relate to double-A ratings. Of the 17.25% unrated assets, 15.48% are guaranteed by sovereigns whilst the remainder are obligations of or guaranteed by public sector entities. In this analysis, the rating is taken as the lowest awarded by the three major ECAs.

### The credit approval process

The Group operates an independent credit approval process, which includes assessments by, and formal limit recommendations from, credit analysts not involved in the business areas.

The allocation of an internal rating determines both the pricing and the potential exposure amount. The Group Credit Committee operates on authority devolved to it by the Group CEO and ultimately the Group Board of Directors and is empowered to set limits up to prudent levels taking into account large exposure parameters.

The credit process centres on an independent Credit Committee which presides over the four counterparty risk pools, and which is provided with both rating and limit recommendations from the dedicated independent risk teams.

The heads of Group risk units report directly to their respective Group Executive Committee Member as well as the Group Credit Committee.

The monitoring of sub-sovereign and country limits and duration utilisation, large exposures and default events is carried out on a Group-wide basis by monitoring staff dedicated to this function.

To monitor the counterparty risk arising from Treasury business, the Group has a Group-wide counterparty limit system that directly accesses the front-office system used by the Group Treasury division, providing real-time information on limits and limit utilisation. The credit exposure resulting from these transactions is calculated on a mark-to-market basis, taking into consideration any relevant regulatory adjustments.

## Market risk

Market risk refers to the risk of potential loss arising from changes in interest rates, foreign currency exchange rates, equity prices, price or rate volatilities and other relevant market rates and prices such as commodity prices. The Bank defines its market risk as changes in fair value of financial instruments as a result of rate, price and volatility movements. The Group's market risk policies and procedures follow three core principles:

- Policy framework for all key market risk activities approved by the Board
- Market risk management is centralised in the Asset & Liability Committee and the treasury and product units, managed by specialised personnel and monitored using appropriate systems and controls.
- The Market risk control function measures and monitors the risks independently of the risk-taking units.

These Group policies and procedures are applied to the Bank.

The market risk control function has sub-categorised market risk into risk factors. The relevant risk factors for the Bank are interest rate and foreign exchange risk. As a Bank focusing on the issuance of asset covered bonds, it is not generally exposed to equity or commodity risk. With regard to foreign exchange risk, the Group has a strict policy that Group Treasury must match all foreign currency assets with liabilities in the same currency or swap out the foreign exchange exposure. Hence, the primary risk factor for the Bank is interest rate risk.

For the quantification and control of this risk, the Bank determines daily Value at Risk (VaR) figures in line with industry wide practice using the variance/co-variance methodology. A ten-day holding period with a 99% confidence interval is used to derive the calculation.

The correlation and volatility frequencies for the calculation are annualised to 250 trading days.

The choice of a ten-day holding period was selected to give a conservative VaR measure in relation to hedging the risk of the portfolio's positions. Senior management recognises that VaR has certain inherent limitations. The past may not always provide a reliable indicator of future market movements and the statistical assumptions employed may understate the probability of very large market moves. For this reason additional management tools such as sensitivity measures, back-testing and stress testing are used to supplement VaR.

## Operational risk

The Bank has adopted the Bank of International Settlements (BIS) definition of Operational Risk: "the risk of losses resulting from inadequate or failed internal processes and systems, or from external events." The Bank applies Group policies and procedures in relation to the management of operational risk.

The objectives of the operational risk processes in the Group are to minimise operational risk by:

- Documentation of all relevant policies, procedures and processes;
- Identification and rectification of sources of errors and weaknesses;
- Employing suitably qualified and experienced personnel;
- The annual appraisal process and regular review of goals and objectives;
- Application of a robust and reliable systems environment;
- Maintenance and regular review of business continuity plans and procedures;
- Sound control systems.

Management of operational risk is the responsibility of all operational units within the Group. The Group operational risk function assists management and staff of the Bank in the assessment and prioritisation of risks through the provision of tools and methodologies, and reports to senior management on the operational risk profile of the Bank. Internal Audit validates the process for management of operational risk, and provides independent assurance that the system of internal control is adequate and assesses the effectiveness of controls implemented to mitigate risks.

All major system components, such as computer hardware, communication links or trading sites are duplicated, synchronised and hosted in different locations. This is an integral part of the Business Continuity Plan, protecting the Bank from an externally caused major disaster.

The Bank's control system relies on strict organisational independence of the monitoring and control functions, detailed segregation of functions and duties and the application of the four-eyes principle to all relevant actions and decision processes. The risk monitoring functions for credit, market and operational risk and the Compliance and Internal Audit functions are the major pillars of the Bank's control system.

### **Liquidity risk**

Liquidity risk is defined as the risk of being unable to fulfil current or future payment obligations in full on or at the due date.

The Bank's liquidity management controls monitor the cash flow of the business in such a manner as to ensure that efficient use of cash flows is maintained. To this extent, the Bank primarily funds its assets through the issuance of asset covered securities. The Bank has agreed to over-collateralisation of the cover pool with respect to the securities issued at a minimum level of 5%. The Bank is also obliged to ensure that the interest payable in a given period of 12 months in respect of the issued securities is less than the total amount of interest receivable on the cover pool.

Assets held outside the cover pool prior to future covered bond issuance either pay a floating rate return or are swapped to a floating return through the use of derivative transactions. These assets are in turn primarily financed through inter-company loans.

### **Hedging**

The Bank's policy is to hedge the following exposures:

- Interest rate risk – using interest rate swaps.
- Currency exposures – using cross-currency swaps and forward foreign exchange.

The following table provides examples of certain activities undertaken by the Bank, the related risks associated with such activities and the types of derivatives used in managing such risks. Such risks may also be managed by using on-balance sheet instruments as part of an integrated approach to risk management.

Activity	Risk	Type of hedge
Fixed rate lending/borrowing	Sensitivity to increases/decreases in interest rates	Pay/receive fixed interest rate swaps
Investment in foreign currency assets/liabilities	Sensitivity to strengthening/weakening of Euro against other currencies	Cross-currency swaps Foreign exchange swaps Foreign currency funding

### Auditors

PricewaterhouseCoopers will continue in office in accordance with the provisions of Section 160 of the Companies Act 1963.

On behalf of the Board

Mr. B. Heide-Ottosen  
Director

Dr. T. P. Carey  
Director

Mr. M. Deeny  
Director

Ms. E. Tiernan  
Company Secretary

12 April 2006

# Independent auditors' report to the members of DEPFA ACS BANK

We have audited the financial statements of DEPFA ACS BANK for the year ended 31 December 2005 which comprise the Income Statement, the Balance Sheet, the Cash Flow Statement, the Statement of Changes in Shareholders' Equity and the related notes. These financial statements have been prepared under the accounting policies set out therein.

## Respective responsibilities of directors and auditors

The directors' responsibilities for preparing the Annual Report and the financial statements, in accordance with applicable Irish law and International Financial Reporting Standards (IFRSs) as adopted by the European Union, are set out in the Statement of Directors' Responsibilities.

Our responsibility is to audit the financial statements in accordance with relevant legal and regulatory requirements and International Standards on Auditing (UK and Ireland). This report, including the opinion, has been prepared for and only for the company's members as a body in accordance with Section 193 of the Companies Act, 1990 and for no other purpose. We do not, in giving this opinion, accept or assume responsibility for any other purpose or to any other person to whom this report is shown or into whose hands it may come save where expressly agreed by our prior consent in writing.

We report to you our opinion as to whether the financial statements give a true and fair view, in accordance with IFRSs as adopted by the European Union, and have been properly prepared in accordance with Irish statute comprising the Companies Acts, 1963 to 2005 and the European Communities (Credit Institutions: Accounts) Regulations, 1992. We state whether we have obtained all the information and explanations we consider necessary for the purposes of our audit, and whether the financial statements are in agreement with the books of account. We also report to you our opinion as to:

- whether the company has kept proper books of account;
- whether the directors' report is consistent with the financial statements; and
- whether at the balance sheet date there existed a financial situation which may require the company to convene an extraordinary general meeting of the company; such a financial situation may exist if the net assets of the company, as stated in the balance sheet, are not more than half of its called-up share capital.

We also report to you if, in our opinion, any information specified by law regarding directors' remuneration and directors' transactions is not disclosed and, where practicable, include such information in our report.

## Basis of audit opinion

We conducted our audit in accordance with International Standards on Auditing (UK and Ireland) issued by the Auditing Practices Board. An audit includes examination, on a test basis, of evidence relevant to the amounts and disclosures in the financial statements. It also includes an assessment of the significant estimates and judgments made by the directors in the preparation of the financial statements, and of whether the accounting policies are appropriate to the company's circumstances, consistently applied and adequately disclosed.

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

## Opinion

In our opinion the financial statements:

- give a true and fair view, in accordance with IFRSs as adopted by the European Union, of the state of the company's affairs as at 31 December 2005 and of its profit and cash flows for the year then ended; and
- have been properly prepared in accordance with the Companies Acts, 1963 to 2005 and the European Communities (Credit Institutions: Accounts) Regulations, 1992.

We have obtained all the information and explanations which we consider necessary for the purposes of our audit. In our opinion proper books of account have been kept by the company. The financial statements are in agreement with the books of account.

In our opinion the information given in the directors' report is consistent with the financial statements.

The net assets of the company, as stated in the balance sheet are more than half of the amount of its called-up share capital and, in our opinion, on that basis there did not exist at 31 December 2005 a financial situation which under Section 40 (1) of the Companies (Amendment) Act, 1983 would require the convening of an extraordinary general meeting of the company.

PricewaterhouseCoopers  
Chartered Accountants and Registered Auditors  
Dublin

12 April 2006

## Income Statement

	Note	Year ended 31 December	
		2005 € 000	2004 € 000
Interest and similar income	6	1,608,214	925,759
Interest expense and similar charges	6	-1,552,088	-880,252
<b>Net interest income</b>		<b>56,126</b>	<b>45,507</b>
Net fee and commission expense		-769	-1,102
Net trading income	7	6,892	-1,518
Gains less losses from financial assets	8	25,859	951
Other operating income	9	1,450	1,110
<b>Total Operating Income</b>		<b>89,558</b>	<b>44,948</b>
Operating expenses	10	-8,748	-9,489
<b>Operating profit</b>		<b>80,810</b>	<b>35,459</b>
Taxation	12	-8,225	-3,578
<b>Profit for the year</b>		<b>72,585</b>	<b>31,881</b>
<b>Earnings per share attributable to the equity holders of the bank (€ per share):</b>	<b>13</b>		
- basic		0.16	0.10
- diluted		0.16	0.10

The notes on pages 16 to 55 are an integral part of these financial statements.

Mr. B. Heide-Ottosen  
Director

Dr. T. P. Carey  
Director

Mr. M. Deeny  
Director

Ms. E. Tiernan  
Company Secretary

12 April 2006

## Balance Sheet

	Note	As at 31 December	
		2005 € 000	2004 € 000
<b>ASSETS</b>			
Cash and balances with central banks	14	8,552	2,821
Loans and advances to banks	15	13,906,176	9,809,515
Derivative financial instruments	16	1,378,388	1,180,099
Loans and advances to customers	17	39,019,408	26,748,466
Investment securities – available-for-sale	18	3,997,793	1,744,037
Pledged assets	19	-	503,626
Other assets		5,134	113
<b>Total assets</b>		<b>58,315,451</b>	<b>39,988,677</b>
<b>LIABILITIES</b>			
Deposits from banks	20	18,146,576	14,638,916
Derivative financial instruments	16	2,773,987	1,725,903
Due to customers	21	-	69,559
Debt securities in issue	22	36,518,796	22,867,518
Other borrowed funds	23	256,492	206,385
Other liabilities	24	15,691	12,867
Current tax liabilities		1,328	1,386
Deferred tax liabilities	25	2,405	2,487
<b>Total liabilities</b>		<b>57,715,275</b>	<b>39,525,021</b>
<b>EQUITY</b>			
<b>Equity attributable to equity holders of the company</b>			
Share capital	26	510,000	395,000
Retained earnings	27	71,035	48,363
Other reserves	28	19,141	20,293
<b>Total equity</b>		<b>600,176</b>	<b>463,656</b>
<b>Total equity and liabilities</b>		<b>58,315,451</b>	<b>39,988,677</b>

The notes on pages 16 to 55 are an integral part of these financial statements.

Mr. B. Heide-Ottosen  
Director

Dr. T. P. Carey  
Director

Mr. M. Deeny  
Director

Ms. E. Tiernan  
Company Secretary

12 April 2006

## Statement of Changes in Equity

€ 000	Share capital	Retained earnings	Other reserves		Total shareholders' equity
			unrealised gains/ losses on cashflow hedges	unrealised gains/ losses on available-for-sale securities	
<b>Balance at 1 January 2004</b>	<b>235,000</b>	<b>16,482</b>	-	<b>16,997</b>	<b>268,479</b>
Profit for the year	-	31,881	-	-	31,881
Net change in available-for-sale investments, net of tax	-	-	-	3,296	3,296
Net changes in cash flow hedges, net of tax	-	-	-	-	-
<b>Total recognised income</b>	<b>-</b>	<b>31,881</b>	<b>-</b>	<b>3,296</b>	<b>35,177</b>
Issue of share capital	160,000	-	-	-	160,000
<b>Balance at 31 December 2004</b>	<b>395,000</b>	<b>48,363</b>	<b>-</b>	<b>20,293</b>	<b>463,656</b>
Profit for the year	-	72,585	-	-	72,585
Net change in available-for-sale investments, net of tax	-	-	-	-1,152	-1,152
Net changes in cash flow hedges, net of tax	-	-	-	-	-
<b>Total recognised income</b>	<b>-</b>	<b>72,585</b>	<b>-</b>	<b>-1,152</b>	<b>71,433</b>
Dividends	-	-49,913	-	-	-49,913
Issue of share capital	115,000	-	-	-	115,000
<b>Balance at 31 December 2005</b>	<b>510,000</b>	<b>71,035</b>	<b>-</b>	<b>19,141</b>	<b>600,176</b>

The notes on pages 16 to 55 are an integral part of these financial statements.

## Cash Flow Statement

	Note	2005 € 000	2004 € 000
<b>Cash flows from operating activities</b>			
<b>Operating profit</b>		<b>80,810</b>	<b>35,459</b>
Adjustments for non-cash movements:			
Foreign exchange gain/loss		-236	414
Net (increase)/decrease in accrued interest income		-510,201	-356,330
Net increase in accrued interest expenditure		511,658	347,362
Gains/losses on sale of investment securities and loans		-25,859	-951
Other non-cash items		18,067	9,615
Net (increase)/decrease in loans and advances to banks		-4,073,671	-1,588,618
Net (increase)/decrease in loans and advances to customers		-10,815,729	-11,171,499
Purchase of investment securities		-2,597,635	-646,980
Sale/maturity of investment securities		1,035,067	708,427
Net (increase)/decrease in other assets		-5,022	137
Net increase/(decrease) in deposits from other banks		3,201,590	616,898
Net increase/(decrease) in amounts due to customers		-69,667	40,842
Net increase/(decrease) in debt securities issued		13,014,838	11,751,371
Net increase/(decrease) in other liabilities		-5,378	-24,500
Net increase/(decrease) in derivatives		110,847	48,523
<b>Net cash from operating activities</b>		<b>-130,521</b>	<b>-229,830</b>
<b>Cash flows from financing activities</b>			
New issues of other borrowed funds		50,000	90,627
Issue of ordinary shares		115,000	160,000
Dividends paid		-49,913	-
<b>Net cash from financing activities</b>		<b>115,087</b>	<b>250,627</b>
<b>Net increase in cash and cash equivalents</b>		<b>-15,434</b>	<b>20,797</b>
<b>Cash and cash equivalents at the beginning of the year</b>		<b>26,012</b>	<b>4,905</b>
Effect of exchange rate changes on cash and cash equivalents		-280	310
<b>Cash and cash equivalents at the end of the year</b>	<b>30</b>	<b>10,298</b>	<b>26,012</b>

# Notes to the Financial Statements

## 1. General information

The Bank's primary activity is the issuance of covered bonds under the Irish Asset Covered Securities Act ("the Legislation") enacted in 2001. These fixed or floating rate instruments are covered by a pool of assets, which include mandatory over-collateralisation assets, all of which are public sector and located in member countries of the European Economic Area (EEA) and certain G7 countries, and relevant derivatives. The Bank generates public sector assets primarily through its parent to support these activities. The Bank has a full banking licence and is a designated credit institution (DCI) as defined in the Legislation. The Bank is regulated by the Irish Financial Regulator.

## 2. Summary of significant accounting policies

The principal accounting policies adopted in the preparation of these financial statements are set out below. These policies have been consistently applied to all the years presented, unless otherwise stated.

### Basis of preparation

These financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRS") and IFRIC interpretations endorsed by the European Union (EU) and with those parts of the Companies Act, 1963 to 2005 applicable to companies reporting under IFRS and the European Communities (Credit Institutions: Accounts) Regulations 1992. The financial statements have been prepared under the historical cost convention as modified by the revaluation of available-for-sale investments and derivatives.

The transition to IFRS has resulted in a number of adjustments to the accounting policies of the Bank and the presentation of the income statement, balance sheet, and cash flow statement. Comparative figures for 2004 have been restated and the accumulated effect of the adjustments is recognised in shareholders' equity at 1 January 2004. Full details of these adjustments are included in note 3 to the financial statements.

The preparation of financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Although these estimates are based on management's best knowledge of the amount, event or actions, the actual results ultimately may differ from those estimates. The areas involving a higher degree of judgment or complexity or areas where assumptions and estimates are significant to the financial statements are disclosed in note 5.

### Foreign currency translation

Foreign currency transactions are translated into Euro using the exchange rates prevailing at the dates of the transactions. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the income statement, except when deferred in equity as qualifying cash flow hedges.

### Interest income and expense

Interest income and expense are recognised in the income statement for all interest bearing financial instruments using the effective interest method.

The effective interest method is a method of calculating the amortised cost of a financial asset or 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 financial liability. When calculating the effective interest rate, the Bank estimates cash flows considering all contractual terms of the financial instrument (for example prepayment options) but does not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate, transaction costs and all other premiums or discounts.

### **Financial assets and liabilities**

Fees and commissions which are not part of the effective interest rate calculation are generally recognised on an accruals basis when the service has been provided.

Commitment fees, together with related direct costs for loan facilities where draw down is probable, are deferred and recognised as an adjustment to the effective interest on the loan once drawn. Commitment fees in relation to facilities where draw down is not probable are recognised over the term of the commitment in fee and commission income.

### **Fee and commission income**

The Bank classifies its financial assets in the following categories: financial assets at fair value through profit or loss, loans and receivables, held-to-maturity investments, and available-for-sale financial assets. Financial liabilities are held at fair value through profit and loss or at amortised cost. Management determines the classification of its financial instruments at initial recognition or in accordance with the transition rules set out in IFRS 1, as appropriate.

#### *(a) Financial assets and financial liabilities at fair value through profit or loss*

This category has two sub-categories: financial assets held for trading, and those designated at fair value through profit or loss prior to 1 September 2005 or, if later, at inception. A financial asset is classified as fair value through profit or loss if acquired principally for the purpose of selling in the short term or if so designated by management in accordance with the fair value rules as set out in IAS 39 "Financial Instruments: Recognition and Measurement", namely:

- The designation eliminates or significantly reduces a measurement or recognition inconsistency that would otherwise arise from measuring assets and liabilities or the gains and losses on them on different bases; or
- A group of financial assets or liabilities is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to management.

Derivatives are also categorised as held for trading unless they are designated as hedges. Interest on financial assets and financial liabilities at fair value through profit or loss and interest on trading derivatives is included in net interest income. Other gains and losses arising from changes in fair value of these financial instruments are included in the income statement within the trading result.

#### *(b) Loans and receivables*

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

On initial recognition, each financial asset is assessed, based on observable market data and judgment, where appropriate, as to whether it is quoted in an active market.

### *(c) Held-to-maturity*

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity. Were the Bank to sell other than an insignificant amount of held-to-maturity assets, the entire category would be tainted and reclassified as available for sale.

### *(d) Available-for-sale*

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates or exchange rates.

Regular purchases and sales of financial assets at fair value through profit or loss, held to maturity and available for sale are recognised on trade-date – the date on which the Bank commits to purchase or sell the asset.

Financial instruments at fair value through profit or loss are initially recognised at fair value with transaction costs being taken to the income statement. Other financial instruments are initially recognised at fair value plus transaction costs. Financial assets are derecognised when the rights to receive cash flows from the financial assets have expired or where the Bank has transferred substantially all risks and rewards of ownership.

Loans and receivables and held-to-maturity investments are subsequently carried at amortised cost using the effective interest rate method.

Available-for-sale financial assets and financial assets at fair value through profit or loss are subsequently carried at fair value. Gains and losses arising from changes in the fair value of financial assets at fair value through profit or loss are included in the income statement in the period in which they arise. Gains and losses arising from changes in the fair value of available-for-sale financial assets are recognised directly in equity, until the financial asset is derecognised or impaired at which time the cumulative gain or loss previously recognised in equity will be recognised in the income statement. However, interest calculated using the effective interest method is recognised in the income statement.

The fair values of financial instruments in active markets are based on current bid prices for assets and offer prices for liabilities. If the market for a financial instrument is not active (and for unlisted securities), the Bank establishes fair value by using valuation techniques. These include the use of recent arm's length transactions, discounted cash flow analysis or other valuation techniques commonly used by market participants.

## **Derivative financial instruments and hedge accounting**

### ***Derivatives***

Derivatives are used for hedging purposes. They include, in particular, interest rate swaps, cross-currency swaps, interest rate options, and foreign exchange forwards.

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value. Fair values are obtained from quoted market prices in active markets, including recent market transactions, and valuation techniques, including discounted cash flow models and options pricing models, as appropriate.

All derivatives are carried as assets when fair value is positive and as liabilities when fair value is negative.

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

whose variables include only data from observable markets. Where such evidence exists, the Bank recognises profits on day one. Where such evidence does not exist, day one profit is deferred and recognised in the income statement to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price. Straight line amortisation is used where it approximates the above.

### ***Embedded derivatives***

Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic characteristics and risks are not closely related to those of the host contract and the host contract is not carried at fair value through profit or loss. These embedded derivatives are measured at fair value with changes in fair value recognised in the income statement.

### ***Hedging derivatives***

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either:

- (a) hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge); or,
- (b) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow hedge).

Hedge accounting is used for derivatives designated in this way 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.

#### ***(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 ineffective portion is included in the trading result with the remainder of the fair value movement on the underlying and the derivative being included in interest.

If the hedge no longer meets the criteria for hedge accounting, the adjustment to the carrying amount of a hedged item for which the effective interest method is used is amortised to the income statement over the period to maturity.

#### ***(b) Cash flow hedge***

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement in the trading result.

Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss (for example, when the forecast sale that is hedged takes place). The transfer is to the income statement account which includes the hedged item.

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 equity at that time remains in equity and is recognised when the forecast transaction is ultimately recognised in the income statement. When a forecast transaction is no longer expected to occur, the cumulative gain or loss that was reported in equity is immediately transferred to the income statement.

## Derivatives that do not qualify for hedge accounting

Some derivatives, while being economic hedges, do not meet detailed hedge accounting criteria under IFRS and therefore do not qualify for hedge accounting. Derivatives that do not qualify for hedge accounting are classified as held for trading.

## Offsetting financial instruments

Financial assets and liabilities are offset and the net amount reported in the balance sheet when there is a legally enforceable right to offset the recognised amounts and there is an intention to settle on a net basis, or realise the asset and settle the liability simultaneously.

## Sale and repurchase agreements

Securities sold subject to repurchase agreements ('repos') are reclassified in the financial statements as pledged assets when the transferee has the right by contract or custom to sell or repledge the collateral; the counterparty liability is included in deposits from banks or deposits due to customers, as appropriate. Securities purchased under agreements to resell ('reverse repos') are recorded as loans and advances to banks or loans and advances to customers, as appropriate. The difference between sale and repurchase price is treated as interest and accrued over the life of the agreements using the effective interest method.

## Impairment of financial assets

### *(a) Assets carried at amortised cost*

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or group of financial assets is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a 'loss event') and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the Bank about the following loss events:

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

If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortised cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate. The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in the income statement. If a loan or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss is the current effective interest rate determined under the contract.

When a loan is uncollectable, it is written off against the related provision for loan impairment. Such loans are written off after all the necessary procedures have been completed and the amount of the loss has been determined. Subsequent recoveries of amounts previously written off decrease the amount of the provision for loan impairment in the income statement.

#### *(b) Assets carried at fair value*

The Bank assesses at each balance sheet date whether there is objective evidence that a financial asset or a group of financial assets carried at fair value is impaired. If any such evidence exists for available-for-sale financial assets, the cumulative loss – measured as the difference between the acquisition cost and the current fair value, less any impairment loss on that financial asset previously recognised in the income statement – is removed from equity and recognised in the income statement. If, in a subsequent period, the fair value of a debt instrument as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognised in the income statement, the impairment loss is reversed through the income statement.

### **Cash and cash equivalents**

For the purposes of the cash flow statement, cash and cash equivalents comprise balances with less than three months' maturity from the date of acquisition, including cash and non restricted balances with central banks, and loans and advances to banks, excluding amounts due from Group companies.

### **Pension scheme**

The Bank operates a defined contribution scheme.

A defined contribution scheme is a pension plan under which the Bank pays fixed contributions into a separate fund. In these plans the Bank has no legal or constructive obligations to pay further contributions if the fund does not hold sufficient assets to pay all employees the benefits relating to employee service in the current and prior periods.

The Bank pays contributions to privately administered pension insurance plans on a mandatory, contractual or voluntary basis. The Bank has no further payment obligations once the contributions have been paid. The contributions are recognised as employee benefit expense when they are due. Prepaid contributions are recognised as an asset to the extent that a cash refund or a reduction in the future payments is available.

### **Taxation**

Current tax payable on profits, based on the applicable tax law, is recognised as an expense in the period in which profits arise. The tax effects of income tax losses available for carry forward are recognised as an asset when it is probable that future taxable profits will be available against which these losses can be utilised.

Deferred tax is provided in full 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 laws) that have been enacted or substantially enacted by the balance sheet date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

Deferred 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 can be utilised.

Deferred tax related to the fair value remeasurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.

### Issued debt and borrowings

The classification of instruments as a financial liability or an 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 and are presented under deposits from banks, and due to customers, debt securities in issue, or other borrowed funds as appropriate. The dividends on these instruments are recognised in the income statement as interest expense. 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 other operating income or operating expenses.

### Share capital

#### *(a) Share issue costs*

Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

#### *(b) Dividends on ordinary shares*

Dividends on ordinary shares are recognised in equity in the period in which they are approved by the Company's shareholders or paid (if declared by the directors). Dividends for the year that are declared after the balance sheet date are dealt with in note 29.

### Prospective accounting standards

In August 2005 the IASB published IFRS7 "Financial instruments: Disclosures". This new standard revises and enhances the disclosure requirements of IAS 32, 'Financial instruments: disclosure and presentation', and IAS 30, 'Disclosures in the financial statements of banks and similar financial institutions', and combines them in one document. On the same date, the IASB published an amendment to IAS 1, 'Presentation of financial statements', relating to capital disclosures. The amendment requires an entity to disclose certain qualitative and quantitative data about its capital (equity resources). IFRS 7 and the amendment to IAS 1 are effective for the year ended 31 December 2007.

In January 2006, IFRIC issued an Interpretation, "IFRIC 8, 'Scope of IFRS 2'". The Interpretation clarifies that the accounting standard IFRS 2, 'Share-based payment', applies to arrangements where an entity makes share-based payments for apparently nil or inadequate consideration. IFRIC 8 explains that, if the identifiable consideration given appears to be less than the fair value of the equity instruments granted or liability incurred, this situation typically indicates that other consideration has been or will be received. IFRS 2, therefore, applies. IFRIC 8 is effective for the year ended 31 December 2007.

The Bank is currently considering the impact of these accounting standards on its financial statements. Once adopted, it does not expect that they will have a material impact on the Bank's financial position.

### 3. Transition to International Financial Reporting Standards

Up to and including the year ended 31 December 2004, the Bank's statutory financial statements were prepared in accordance with Irish Generally Accepted Accounting Principles ('Irish GAAP').

On 1 January 2005, the Bank implemented the requirements of IFRS for the first time and these standards are used for the purpose of preparing financial statements for the year ending 31 December 2005. Comparative information for 2004 has been restated to take into account the requirements of IFRS.

The rules for first time adoption of IFRS are set out in IFRS 1 "First-time Adoption of International Financial Reporting Standards". IFRS 1 requires the Bank to determine its IFRS accounting policies and apply these retrospectively to determine the opening balance sheet position under IFRS at the date of transition. The Bank's principal accounting policies under IFRS are set out in note 2.

The impact of each mandatory exemption and the voluntary exemptions under IFRS 1 that the Bank chooses to apply are outlined below.

Mandatory exception	Impact
Estimates	The Bank's estimates at the date of transition are consistent with those under Irish GAAP.
Assets held for sale and discontinued operations	The Bank has no transactions prior to 1 January 2005 that are affected by the transitional requirements of IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations".
Hedge Accounting	The Bank has applied the mandatory exception to hedge accounting at 1 January 2004.
Derecognition of financial instruments	Financial instruments derecognised before 1 January 2004 have not been re-recognised by the Bank under IFRS.
Voluntary exemption	Impact
Comparatives for financial instruments and designation of financial assets and liabilities	The Bank has elected not to avail of the exemption under IFRS 1, from the requirement to restate comparative information for IAS 32: Financial Instruments: Disclosure and Presentation and IAS 39: Financial Instruments: Recognition and Measurement.

The significant differences between the Bank's Irish accounting policies and IFRS accounting policies are summarised below:

<b>(a) Dividends</b>	
<p><b>Irish GAAP</b></p> <p>Dividends declared after the period end are recorded in the period to which they relate.</p>	<p><b>IFRS</b></p> <p>Dividends are recorded in the period in which they are approved by the shareholder.</p> <p>This results in an increase in equity on transition as no liability is recognised in the financial statements for proposed dividends.</p>

<b>(b) Deferred tax</b>	
<p><b>Irish GAAP</b></p> <p>Deferred taxation is recognised on all timing differences where the transaction or event that gives rise to an obligation to pay more tax in the future or a right to pay less tax in the future, have occurred by the balance sheet date using rates of tax that have been enacted by the balance sheet date.</p> <p>Deferred tax assets are recognised when it is more likely than not that they will be recovered.</p> <p>Deferred taxation is not provided in respect of timing differences arising from the sale or revaluation of fixed assets unless, by the balance sheet date, a binding commitment to sell the asset has been entered into.</p>	<p><b>IFRS</b></p> <p>Deferred tax is provided on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. Deferred tax is determined using tax rates that have been enacted or substantially enacted by the balance sheet date. Deferred tax related to fair value remeasurement of available-for-sale investments and cash flow hedges, which are charged or credited directly to equity, is also credited or charged directly to equity and is subsequently recognised in the income statement together with the deferred gain or loss.</p> <p>Deferred tax assets are recognised to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised.</p>

### (c) Derivatives and hedge accounting

#### Irish GAAP

Derivative instruments used for trading purposes or used to manage risk in the trading portfolios are measured at fair value and the resultant profits and losses are included in dealing profits. Unrealised gains and losses are reported in Other Assets or Other Liabilities on a gross basis.

Derivatives used for hedging purposes are accounted for on an accruals basis consistent with the accounting treatment of the underlying transaction. The fair value gains and losses on these derivatives are not recognised in the income statement.

Profits and losses related to qualifying hedges of firm commitments and anticipated transactions are deferred and taken to the profit and loss account when the hedged transactions occur.

#### IFRS

Derivatives are initially recognised at fair value on the date on which a derivative contract is entered into and are subsequently remeasured at their fair value at each reporting date.

The method of recognising the resulting fair value gain or loss depends on whether the derivative is designated as a hedging instrument, and if so, the nature of the item being hedged. The Bank designates certain derivatives as either: (1) hedges of the fair value of recognised assets or liabilities or firm commitments (fair value hedge); or, (2) hedges of highly probable future cash flows attributable to a recognised asset or liability, or a forecast transaction (cash flow 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 effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in equity. The gain or loss relating to the ineffective portion is recognised immediately in the income statement. Amounts accumulated in equity are recycled to the income statement in the periods in which the hedged item will affect profit or loss.

Certain derivative instruments do not qualify for hedge accounting. Changes in their fair value are recognised immediately in the income statement.

#### (d) Classification and measurement of financial assets

##### Irish GAAP

Under Irish GAAP, financial assets are classified as loans and advances, investment securities or other securities.

Loans and advances are carried at amortised cost, net of provisions.

Debt securities and equity shares held for use on a continuing basis in the Bank's activities are classified as investment securities. Such securities and shares are stated at amortised cost less provision for any permanent diminution in value.

Other securities and other equity shares are stated at fair value using mid-market values. Changes in the fair value of securities marked to market are recognised in the profit and loss account as they arise and included in dealing profits.

Interest receivable and interest payable are included in prepayments and accrued income and accruals and deferred income respectively.

##### IFRS

Under IFRS, financial assets are classified as either

(a) Financial assets at fair value through profit or loss

A financial asset is classified in this category if acquired principally for the purpose of selling in the short term or if so designated by management in accordance with the fair value rules of IAS 39.

(b) Loans and receivables

This category includes non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.

(c) Held-to-maturity

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturities that the Bank's management has the positive intention and ability to hold to maturity.

(d) Available-for-sale

Available-for-sale investments are those intended to be held for an indefinite period of time, which may be sold in response to needs for liquidity or changes in interest rates, exchange rates or equity prices.

Financial assets are initially recognised at fair value. Available-for-sale and financial assets at fair value through profit or loss are subsequently carried at fair value through equity or the income statement respectively. Loans and receivables and held-to-maturity investments are subsequently carried at amortised cost using the effective interest method.

### (e) Effective interest rate

#### Irish GAAP

Interest income is recognised as it accrues.

Fees and commissions which represent a return for services provided, risk borne or which are in the nature of interest are generally credited to income when the service is performed.

#### IFRS

Interest income and expense are recognised in the income statement using the effective interest rate. This rate includes all fees and points paid or received between parties to the contract, transaction costs and all other premiums or discounts.

Fees earned on the execution of a significant act are recognised immediately

The application of IFRS has resulted in certain fees and commissions being included in interest income.

The tables below set out the impact of these changes upon the Bank's financial position and reconciles the restated comparatives to previously published 2004 Irish GAAP financial statements.

The main impacts on the equity of the Bank at transition date 1 January 2004 are as follows:

€ 000	Per Irish GAAP	Derivatives and hedge accounting/ Measurement of financial instruments (d) (e)	Per IFRS
Share capital	235,000	-	235,000
Retained earnings	16,726	-244	16,482
Unrealised gains/losses on AFS investments	-	16,997	16,997
<b>Total equity</b>	<b>251,726</b>	<b>16,753</b>	<b>268,479</b>

Reconciliation of total assets from Irish GAAP to IFRS

€ 000	Irish GAAP 31/12/04	Derivatives and hedge accounting/ Measurement of financial instruments (b) (c) (d)	Reclassifications (d) (e)	IFRS 31/12/04
Cash and balances with central banks	2,817	-	4	2,821
Loans and advances to banks	9,006,607	93,632	709,276	9,809,515
Derivative financial instruments	-	767,700	412,399	1,180,099
Loans and advances to customers	18,180,277	496,988	8,071,201	26,748,466
Investment securities – available-for-sale	-	-	1,744,037	1,744,037
Debt securities and other fixed income securities	10,098,944	511,841	-10,610,785	-
Pledged assets	-	-	503,626	503,626
Prepayments and accrued income	941,453	-	-941,453	-
Other assets	113	-	-	113
<b>Total assets</b>	<b>38,230,211</b>	<b>1,870,161</b>	<b>-111,695</b>	<b>39,988,677</b>

Reconciliation of total liabilities and equity from Irish GAAP to IFRS

€ 000	Irish GAAP 31/12/04	Derivatives and hedge accounting/ Measurement of financial instruments (b)(c) (d)	Dividends (a)	Reclassifications (d) (e)	IFRS 31/12/04
Deposits from banks	14,616,265	-104	-	22,755	14,638,916
Derivative financial instruments	-	1,400,347	-	325,556	1,725,903
Due to customers	69,208	-	-	351	69,559
Debt securities in issue	21,907,000	511,800	-	448,718	22,867,518
Other borrowed funds	205,627	-	-	758	206,385
Other liabilities	127,278	-63,112	-49,913	-1,386	12,867
Accruals and deferred income	909,833	-	-	-909,833	-
Current tax liabilities	-	-	-	1,386	1,386
Deferred tax liabilities	-	2,487	-	-	2,487
<b>Total liabilities</b>	<b>37,835,211</b>	<b>1,851,418</b>	<b>-49,913</b>	<b>-111,695</b>	<b>39,525,021</b>
Share capital	395,000	-	-	-	395,000
Retained earnings	-	-1,550	49,913	-	48,363
Other reserves	-	20,293	-	-	20,293
<b>Shareholders' equity</b>	<b>395,000</b>	<b>18,743</b>	<b>49,913</b>	<b>-</b>	<b>463,656</b>
<b>Total equity and liabilities</b>	<b>38,230,211</b>	<b>1,870,161</b>	<b>-</b>	<b>-111,695</b>	<b>39,988,677</b>

Reconciliation of income statement from Irish GAAP to IFRS

€ 000	Irish GAAP 31/12/04	Derivatives and hedge accounting/ Measurement of financial instruments (d) (e)	Reclassifications (d) (e)	IFRS 31/12/04
Net interest income	46,888	-	-1,381	45,507
Net fee and commission income	-2,483	-	1,381	-1,102
Net trading income	-	-1,414	-104	-1,518
Gains less losses from financial assets	951	-	-	951
Other operating income	1,110	-	-	1,110
<b>Total operating income</b>	<b>46,466</b>	<b>-1,414</b>	<b>-104</b>	<b>44,948</b>
Administrative expenditure	-9,489	-	-	-9,489
Other operating expenditure	-104	-	104	-
<b>Operating profit</b>	<b>36,873</b>	<b>-1,414</b>	<b>-</b>	<b>35,459</b>
Taxation	-3,687	109	-	-3,578
<b>Profit for the year</b>	<b>33,186</b>	<b>-1,305</b>	<b>-</b>	<b>31,881</b>

## 4. Financial risk management

### Strategy in using financial instruments

The Bank is party to various types of financial instruments in the normal course of business to reduce its own exposure to fluctuations in interest and exchange rates. These financial instruments involve, to varying degrees, exposure to loss in the event of a default by a counterparty ("credit risk") and exposure to future changes in interest and exchange rates ("market risk"). In addition, the Bank is exposed to liquidity risk to the extent that it is exposed to regular calls on its available cash resources.

In the course of the Bank's banking activities, it makes significant use of financial instruments, including derivatives. The Bank purchases assets at both fixed and floating rates and for varying maturities. The Bank then manages the interest rate risk on these fixed rate positions, by swapping them into a floating rate exposure, using interest rate derivatives.

The Bank also raises finance at both floating and fixed rates and for varying maturities. In a similar manner to the asset side, the Bank will manage the interest rate risk on fixed rate positions, where deemed appropriate, by converting them into a floating rate exposure, using interest rate derivatives.

### Fair value hedges

The Bank hedges substantially all of the fixed interest rate risk in its long term financial assets and financial liabilities, through fair value hedges using a variety of interest rate derivatives. The Bank also hedges foreign exchange risk using a variety of foreign exchange derivatives. The net fair value of these derivatives at 31 December 2005 was - € 1,286 million (2004: - € 400 million).

### Cash flow hedges

The Bank also hedges a portion of the cash flow interest rate and foreign currency risk arising on future payments and receipts on variable rate assets and liabilities. The Bank manages this risk through the use of interest rate swaps and cross currency interest rate swaps. The net fair value of these derivatives at 31 December 2005 was - € 17 million (2004: - € 73 million).

The Bank's policies and objectives in managing the risks that arise in connection with the use of financial instruments are set out in the section marked credit risk, market risk and liquidity risk in the directors' report on pages 6 to 8.

### Credit risk

The Bank takes on exposure to credit risk, which is the risk that a counterparty will be unable to pay amounts owed in full when due. Impairment provisions are provided for losses that have been incurred at the balance sheet date. Significant changes in the economy, or in the health of a particular segment that represents a concentration in the Bank's portfolio, could result in losses that are different from those provided for at the balance sheet date. Management therefore carefully manages its exposure to credit risk.

The Bank restricts its exposure to credit losses by entering into collateral support agreements and master netting arrangements with counterparties with which it undertakes a significant volume of transactions.

Under the terms of a collateral support agreement, in the event that the value of a counterparty's derivative exposure to the Bank exceeds a defined limit, the counterparty must post collateral to the amount of the excess with the Bank. In the event of a default by the counterparty, the Bank then has recourse to the collateral, up to the amount of the loss suffered.

Master netting arrangements do not generally result in an offset of balance sheet assets and liabilities, as transactions are usually settled on a gross basis. However, the credit risk associated with favourable contracts is reduced by a master netting arrangement to the extent that if an event of default occurs, all amounts with the counterparty are terminated and settled on a net basis. The Bank's overall exposure to credit risk on derivative instruments subject to master netting arrangements can change substantially within a short period, as it is affected by each transaction subject to the arrangement.

#### Geographical concentrations of assets, liabilities and off-balance sheet items

€ 000	Total assets	Total liabilities	Credit commitments
<b>At 31 December 2005</b>			
Germany	7,780,164	481,772	7,530
Italy	9,415,254	-	-
France	2,725,642	127,897	21,940
Britain	1,979,156	732,928	7,296
Spain	7,640,297	325	842,000
Austria	1,296,086	-	-
Greece	1,494,156	-	-
Ireland	9,865,357	19,515,133	24,030
Other European countries	9,816,241	217,262	253,258
USA	4,123,712	121,121	147,780
Canada	1,328,686	-	-
Japan	449,231	2	-
Other countries	401,469	-	-
Unallocated assets / liabilities	-	36,518,835	-
<b>Total</b>	<b>58,315,451</b>	<b>57,715,275</b>	<b>1,303,834</b>

€ 000	Total assets	Total liabilities	Credit commitments
<b>At 31 December 2004</b>			
Germany	7,374,577	1,773,292	-
Italy	5,809,329	-	-
France	2,126,091	31,214	89,379
Britain	633,437	192,849	-
Spain	6,286,113	539	766,145
Austria	821,530	-	-
Greece	1,257,555	-	-
Ireland	6,510,717	14,681,868	-
Other European countries	7,067,542	346,828	28,407
USA	1,417,059	215,557	147,780
Canada	449,454	-	-
Japan	235,273	-	-
Other countries	-	-	-
Unallocated assets / liabilities	-	22,282,874	-
<b>Total</b>	<b>39,988,677</b>	<b>39,525,021</b>	<b>1,031,711</b>

Assets are allocated geographically based on the location of the credit risk. Liabilities are allocated on the basis of the location of the counterparty where this can be identified. Credit commitments are allocated based on the location of the credit risk.

Included in unallocated liabilities are all debt securities in issue where the counterparty cannot be specifically identified as the securities are transferable.

The concentration of credit risk by counterparty type for loans and advances to banks and customers, securities and derivatives is summarised below:

€ 000	31/12/2005			
	Loans	Securities	Derivatives	Total
Public authorities	43,837,970	3,997,793	-	47,835,763
Companies and private individuals	55,574	-	445	56,019
Banks and financial institutions	9,032,040	-	1,377,943	10,409,983
	<b>52,925,584</b>	<b>3,997,793</b>	<b>1,378,388</b>	<b>58,301,765</b>

€ 000	31/12/2004			
	Loans	Securities	Derivatives	Total
Public authorities	30,290,510	2,247,663	-	32,538,173
Companies and private individuals	70,392	-	-	70,392
Banks and financial institutions	6,197,079	-	1,180,099	7,377,178
	<b>36,557,981</b>	<b>2,247,663</b>	<b>1,180,099</b>	<b>39,985,743</b>

### Market risk

Market risks arise from open positions in interest rate, currency and equity products, all of which are exposed to general and specific market movements. The Bank applies a VaR methodology to estimate the market risk of positions held and the maximum losses expected, based upon a number of assumptions for various changes in market conditions. The Board sets limits on the value at risk that may be accepted, which is monitored on a daily basis.

Two of the principal components of market risk for the Bank are currency risk and fair value interest rate risk.

### Currency risk

The Bank takes on exposure to effects of fluctuations in the prevailing foreign currency exchange rates on its financial position and cash flows. The Group sets limits on the level of exposure by currency and in total for both overnight and intra-day positions, which are monitored daily. The table below summarises the Bank's exposure to foreign currency exchange rate risk at 31 December. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by currency.

€ 000	EUR	USD	JPY	GBP	Other	Total
<b>As at 31 December 2005</b>						
<b>Assets</b>						
Cash and balances with central banks	8,552	-	-	-	-	8,552
Loans and advances to banks	12,909,978	623,514	146,017	40,720	185,947	13,906,176
Derivative financial instruments	880,806	-363,520	260,895	9,328	590,879	1,378,388
Loans and advances to customers	28,549,105	6,322,206	6,855	2,098,512	2,042,730	39,019,408
Investment securities	1,718,161	1,013,800	266,302	560,704	438,826	3,997,793
Other assets	5,132	2	-	-	-	5,134
<b>Total assets</b>	<b>44,071,734</b>	<b>7,596,002</b>	<b>680,069</b>	<b>2,709,264</b>	<b>3,258,382</b>	<b>58,315,451</b>
<b>Liabilities</b>						
Deposits from banks	13,575,381	2,004,254	86,395	1,287,570	1,192,976	18,146,576
Derivative financial instruments	3,122,995	-15,741	-905,868	441,860	130,741	2,773,987
Due to customers	-	-	-	-	-	-
Debt securities in issue	26,502,083	5,603,805	1,498,992	979,978	1,933,938	36,518,796
Other borrowed funds	256,492	-	-	-	-	256,492
Other liabilities	15,686	3	2	-	-	15,691
Current income tax liabilities	1,328	-	-	-	-	1,328
Deferred income tax liabilities	2,405	-	-	-	-	2,405
<b>Total liabilities</b>	<b>43,476,370</b>	<b>7,592,321</b>	<b>679,521</b>	<b>2,709,408</b>	<b>3,257,655</b>	<b>57,715,275</b>
<b>Net on-balance sheet position</b>	<b>595,364</b>	<b>3,681</b>	<b>548</b>	<b>-144</b>	<b>727</b>	<b>600,176</b>
<b>Credit commitments</b>	<b>1,229,620</b>	<b>-</b>	<b>-</b>	<b>7,296</b>	<b>66,918</b>	<b>1,303,834</b>
<b>As at 31 December 2004</b>						
Total assets	34,719,773	2,516,440	267,647	949,886	1,534,931	39,988,677
Total liabilities	34,267,759	2,508,752	265,038	950,835	1,532,637	39,525,021
<b>Net on-balance sheet position</b>	<b>452,014</b>	<b>7,688</b>	<b>2,609</b>	<b>-949</b>	<b>2,294</b>	<b>463,656</b>
<b>Credit commitments</b>	<b>1,015,231</b>	<b>-</b>	<b>-</b>	<b>-</b>	<b>16,480</b>	<b>1,031,711</b>

The classification of derivative financial instruments as an asset or liability above is based on the overall fair value of the instruments at year end. To better reflect the manner in which the Group manages its foreign exchange, the notional amounts on both the pay and receive legs of the swap (in Euro equivalents) have been categorised according to their underlying currency.

## Fair value interest rate risk

Fair value interest rate risk is the risk that the value of a financial instrument will fluctuate because of changes in market interest rates. The table below summarises the Bank's exposure to interest rate risks. Included in the table are the Bank's assets and liabilities at carrying amounts, categorised by the earlier of contractual repricing or maturity dates. Expected repricing and maturity dates do not differ significantly from the contract dates.

€ 000	Up to 3 months	3-6 months	6-12 months	1-5 years	Over 5 years	Non interest bearing	Total
<b>As at 31 December 2005</b>							
<b>Assets</b>							
Cash and balances with central banks	6,793	-	1,759	-	-	-	8,552
Loans and advances to banks	9,899,461	16,959	38,147	526,047	3,425,562	-	13,906,176
Derivative financial instruments	-22,436,981	-522,420	-372,297	11,351,386	13,358,700	-	1,378,388
Loans and advances to customers	12,420,011	3,799,351	819,250	5,961,043	16,019,753	-	39,019,408
Investment securities	82,935	40,266	516,781	720,327	2,637,484	-	3,997,793
Other assets	-	-	-	-	-	5,134	5,134
<b>Total assets</b>	<b>-27,781</b>	<b>3,334,156</b>	<b>1,003,640</b>	<b>18,558,803</b>	<b>35,441,499</b>	<b>5,134</b>	<b>58,315,451</b>
<b>Liabilities</b>							
Deposits from banks	15,376,567	2,556,298	100,449	-272	113,534	-	18,146,576
Derivative financial instruments	-17,520,836	-1,261,124	268,746	2,679,738	18,607,463	-	2,773,987
Due to customers	-	-	-	-	-	-	-
Debt securities in issue	2,713,795	756,522	618,725	15,673,347	16,756,407	-	36,518,796
Other borrowed funds	195,223	-	-	-	61,269	-	256,492
Other liabilities	-	-	-	-	-	15,691	15,691
Current income tax liabilities	-	-	-	-	-	1,328	1,328
Deferred income tax liabilities	-	-	-	-	-	2,405	2,405
<b>Total liabilities</b>	<b>764,749</b>	<b>2,051,696</b>	<b>987,920</b>	<b>18,352,813</b>	<b>35,538,673</b>	<b>19,424</b>	<b>57,715,275</b>
<b>Net interest repricing gap</b>	<b>-792,530</b>	<b>1,282,460</b>	<b>15,720</b>	<b>205,990</b>	<b>-97,174</b>	<b>-14,290</b>	<b>600,176</b>

€ 000	Up to 3 months	3-6 months	6-12 months	1-5 years	Over 5 years	Non interest bearing	Total
<b>As at 31 December 2004</b>							
<b>Assets</b>							
Cash and balances with central banks	2,821	-	-	-	-	-	2,821
Loans and advances to banks	6,465,162	9,602	-	337,924	2,996,827	-	9,809,515
Derivative financial instruments	-14,252,182	-2,264,445	-1,513,152	10,585,334	8,624,544	-	1,180,099
Loans and advances to customers	7,635,332	4,929,882	1,696,473	3,331,957	9,154,822	-	26,748,466
Investment securities	416,733	20,441	37,507	407,299	862,057	-	1,744,037
Pledged assets	-	-	-	-	503,626	-	503,626
Other assets	-	-	-	-	-	113	113
<b>Total assets</b>	<b>267,866</b>	<b>2,695,480</b>	<b>220,828</b>	<b>14,662,514</b>	<b>22,141,876</b>	<b>113</b>	<b>39,988,677</b>
<b>Liabilities</b>							
Deposits from banks	12,785,732	1,621,759	231,425	-	-	-	14,638,916
Derivative financial instruments	-11,102,343	-1,215,914	-489,569	1,892,529	12,641,200	-	1,725,903
Due to customers	69,559	-	-	-	-	-	69,559
Debt securities in issue	175,598	447,024	-	12,791,633	9,453,263	-	22,867,518
Other borrowed funds	145,098	-	-	-	61,287	-	206,385
Other liabilities	-	-	-	-	-	12,867	12,867
Current income tax liabilities	-	-	-	-	-	1,386	1,386
Deferred income tax liabilities	-	-	-	-	-	2,487	2,487
<b>Total liabilities</b>	<b>2,073,644</b>	<b>852,869</b>	<b>-258,144</b>	<b>14,684,162</b>	<b>22,155,750</b>	<b>16,740</b>	<b>39,525,021</b>
<b>Net interest repricing gap</b>	<b>-1,805,778</b>	<b>1,842,611</b>	<b>478,972</b>	<b>-21,648</b>	<b>-13,874</b>	<b>-16,627</b>	<b>463,656</b>

The table below summarises the effective interest rate by major currencies for monetary financial instruments not carried at fair value through profit or loss:

<b>As at 31 December 2005</b>	<b>EUR %</b>	<b>USD %</b>	<b>JPY %</b>	<b>GBP %</b>
<b>Assets</b>				
Cash and balances with central banks	2.3			
Loans and advances to banks	2.8	2.5	1.8	10.1
Loans and advances to customers	3.7	5.4	3.4	4.8
Investment securities	3.7	5.1		6.2
<b>Liabilities</b>				
Deposits from banks	2.4	4.4	0.0	4.6
Debt securities in issue	3.4	3.7	1.3	4.7
Other borrowed funds	4.1			

As at 31 December 2004	EUR %	USD %	JPY %	GBP %
<b>Assets</b>				
Cash and balances with central banks	2.0			
Loans and advances to banks	2.8	5.3		9.1
Loans and advances to customers	3.5	4.7	3.5	5.0
Investment securities	3.7	6.2		9.6
<b>Liabilities</b>				
Deposits from banks	2.2	2.5		4.8
Due to customers	2.1			4.9
Debt securities in issue	3.6	3.9	1.3	4.7
Other borrowed funds	4.1			

The majority of the Bank's interest earning assets are entered into at a fixed rate of interest. The fair value interest rate risk on these positions is mitigated, where desirable from a treasury perspective, using interest rate derivatives.

## Liquidity risk

The Bank is exposed to daily calls on its available cash resources from overnight deposits, maturing deposits, loan draw-downs and guarantees, and from margin and other calls on cash-settled derivatives. The Bank does not maintain cash resources to meet all of these needs, as experience shows that a minimum level of reinvestment of maturing funds can be predicted with a high level of certainty. The Group sets limits on the minimum proportion of maturing funds available to meet such calls and on the minimum level of inter-bank and other borrowing facilities that should be in place to cover withdrawals at unexpected levels of demand.

The table below analyses the Bank's assets and liabilities into relevant maturity groupings based on the remaining period at balance sheet date to the contractual maturity date.

€ 000	Up to 3 months	3-12 months	1-5 years	Over 5 years	Non-financial instruments	Total
<b>As at 31 December 2005</b>						
<b>Assets</b>						
Cash and balances with central banks	6,793	1,759	-	-		8,552
Loans and advances to banks	8,762,738	224,831	1,238,263	3,680,344		13,906,176
Derivative financial instruments	3,838	2,586	260,012	1,111,952		1,378,388
Loans and advances to customers	325,057	1,142,778	8,349,934	29,201,639		39,019,408
Investment securities	4,599	48,439	720,335	3,224,420		3,997,793
Pledged assets	-	-	-	-	-	-
Other assets	-	-	-	-	5,134	5,134
<b>Total assets</b>	<b>9,103,025</b>	<b>1,420,393</b>	<b>10,568,544</b>	<b>37,218,355</b>	<b>5,134</b>	<b>58,315,451</b>
<b>Liabilities</b>						
Deposits from banks	15,126,928	2,801,754	-272	218,166	-	18,146,576
Derivative financial instruments	71,779	49,977	581,250	2,070,981	-	2,773,987
Due to customers	-	-	-	-	-	-
Debt securities in issue	-	169,381	16,300,197	20,049,218	-	36,518,796
Other borrowed funds	-	-	-	256,492	-	256,492
Other liabilities	-	-	-	-	15,691	15,691
Current income tax liabilities	-	-	-	-	1,328	1,328
Deferred income tax liabilities	-	-	-	-	2,405	2,405
<b>Total liabilities</b>	<b>15,198,707</b>	<b>3,021,112</b>	<b>16,881,175</b>	<b>22,594,857</b>	<b>19,424</b>	<b>57,715,275</b>
<b>Net liquidity gap</b>	<b>-6,095,682</b>	<b>-1,600,719</b>	<b>-6,312,631</b>	<b>14,623,498</b>	<b>-14,290</b>	<b>600,176</b>
<b>As at 31 December 2004</b>						
Total assets	6,657,912	1,359,826	7,593,259	24,377,578	102	39,988,677
Total liabilities	12,609,341	1,943,334	13,102,897	11,852,709	16,740	39,525,021
<b>Net liquidity gap</b>	<b>-5,951,429</b>	<b>-583,508</b>	<b>-5,509,638</b>	<b>12,524,869</b>	<b>-16,638</b>	<b>463,656</b>

## Fair values of financial assets and liabilities

The following table summarises the carrying amounts and fair values of those financial assets and liabilities not presented on the Bank's balance sheet at their fair value. Bid prices are used to estimate fair values of assets, whereas offer prices are applied for liabilities.

	€ 000			
	Carrying value		Fair value	
	2005	2004	2005	2004
<b>Financial assets</b>				
Loans and advances to banks	13,906,176	9,809,515	13,914,587	9,809,009
Loans and advances to customers	39,019,408	26,748,466	39,204,218	26,805,205
<b>Financial liabilities</b>				
Deposits from banks	18,146,576	14,638,916	18,146,576	14,638,993
Due to customers	-	69,559	-	69,559
Debt securities in issue	36,518,796	22,867,518	36,593,563	22,867,266
Other borrowed funds	256,492	206,385	259,923	213,778

### a) Deposits from banks

The fair value of floating rate placements and overnight deposits is their carrying amount. The estimated fair value of fixed interest bearing deposits is based on discounted cash flows using prevailing money-market interest rates for debts with similar credit risk and remaining maturity.

### b) Loans and advances to banks and customers

Loans and advances are net of provisions for impairment. The estimated fair value of loans and advances represents the discounted amount of estimated future cash flows expected to be received. Expected cash flows are discounted at current market rates for loans and advances with similar credit characteristics to determine fair value.

### c) Deposits and borrowings

The estimated fair value of deposits with no stated maturity, which includes non-interest-bearing deposits, is the amount repayable on demand. The estimated fair value of fixed interest-bearing deposits and other borrowings without quoted market price is based on discounted cash flows using interest rates for new debts with similar remaining maturity.

### d) Debt securities in issue

The aggregate fair values are calculated based on quoted market prices. For those notes where quoted market prices are not available, a discounted cash flow model is used based on a current yield curve appropriate for the remaining term to maturity.

## 5. Critical accounting estimates

The Bank believes that of its significant accounting policies and estimates, the following may involve a higher degree of judgment and complexity.

### *Fair value of financial instruments*

Some of the Bank's financial instruments are carried at fair value, including derivatives and available for sale investments. Fair values are based on quoted market prices or appropriate pricing models. Where models are used, the methodology is to calculate the expected cash flows and discount these back to a present value. The models use independently sourced parameters including interest rate yield curves, equity prices, option volatility and currency rates. The calculation of fair value for any instrument may require adjustment to reflect credit risk (where not embedded in the model used). The valuation model used for a specific instrument, the quality and liquidity of market data and other adjustments all require the exercise of judgement. The use of different models or other assumptions could result in changes in reported financial results.

### *Investment securities*

Investment securities are included as either available-for-sale investments or loans and receivables.

Available-for-sale investments are valued at fair values using market values where available. Where market values are not available, fair values are represented by the use of other means such as price quotations for similar investments, or pricing models.

Loans and receivables have fixed or determinable payments, recover substantially all of their initial investment other than for reasons of credit and must not be quoted in an active market. Due to the specialised market in which the Bank operates and the fact that the majority of the Bank's securities trades are done on a bilateral basis, judgment is required as to whether an active market may be held to exist in a security. Details of the fair value of financial assets not carried at fair value in the financial statements are disclosed in note 4. If an active market was held to exist for these assets, the movement in fair value, net of tax, would be posted to equity.

The Bank conducts regular impairment reviews of its available-for-sale portfolio and considers indicators such as downgrades in credit ratings or breaches of covenants as well as the application of judgment in determining whether creation of a provision is appropriate. The use of different models or other assumptions and methods with respect to the valuation of investment securities could result in changes in reported financial results.

### *Impairment provisions*

The Bank considers the need for impairment provisions at each balance sheet date. The estimation of credit losses is inherently uncertain and depends on many factors such as general economic conditions, cash flows, structural changes and other external factors.

At year end, in the opinion of the directors, no provisions are required. The Bank considers this to be appropriate based on information available at the time. However, actual losses may differ as a result of changes in the timing and amounts of cash flows or other economic events.

## 6. Net interest income

	2005 € 000	2004 € 000
<b>Interest income</b>		
Loans and advances	877,396	450,806
Other lending business and money market transactions	153,242	86,026
Fixed income securities	577,576	388,927
	<b>1,608,214</b>	<b>925,759</b>
<b>Interest expense</b>		
Asset-covered bonds	-930,498	-583,939
Other debt securities	-67,041	-32,015
Borrowings	-62,746	-17,161
Subordinated debt	-7,685	-6,965
Other banking transactions	-484,118	-240,172
	<b>-1,552,088</b>	<b>-880,252</b>

## 7. Net trading income

	2005 € 000	2004 € 000
Derivatives mark-to-market and hedge ineffectiveness	6,376	-1,414
Foreign exchange transaction gains less losses	516	-104
	<b>6,892</b>	<b>-1,518</b>

The Bank does not engage in proprietary trading activities. The trading result consists entirely of marking to market derivatives which do not qualify for hedge accounting, hedge ineffectiveness on qualifying hedges, and foreign exchange gains and losses.

## 8. Gains less losses from financial assets

Gain less losses from financial assets reflect income from the sale of financial assets and amounted to € 25,859 thousand (2004: € 951 thousand)

## 9. Other operating income

	2005 € 000	2004 € 000
Intercompany recharges	1,450	604
Gains on buybacks of debt securities	-	506
	<b>1,450</b>	<b>1,110</b>

Intercompany recharges consist of recharges to other Group entities for certain services provided.

## 10. Operating expenses

	2005 € 000	2004 € 000
Staff costs (note 11)	-2,146	-1,324
Administrative expenses	-6,568	-8,165
Other operating expenditure	-34	-
	<b>-8,748</b>	<b>-9,489</b>

Included in operating expenses are auditors' remuneration of € 120 thousand (2004: € 120 thousand).

## 11. Staff costs

	2005 € 000	2004 € 000
Wages and salaries	-1,875	-1,154
Social security costs	-163	-105
Pension costs	-108	-65
	<b>-2,146</b>	<b>-1,324</b>

## 12. Taxation

	2005 € 000	2004 € 000
Current tax	-8,143	-4,260
Deferred tax (note 25)	-82	682
	<b>-8,225</b>	<b>-3,578</b>

Further information about deferred income tax is presented in note 25.

The tax on the Bank's profit before tax differs from the theoretical amount that would arise using the basic tax rate of the parent as follows:

	2005 € 000	2004 € 000
Profit before tax	80,810	35,459
Tax calculated at a tax rate of 12.5% (2004: 12.5%)	-10,101	-4,432
Effect of different tax rates in Ireland	1,876	854
<b>Income tax expense</b>	<b>-8,225</b>	<b>-3,578</b>

### 13. Earnings per share

Basic earnings per share is calculated by dividing the net profit attributable to equity holders of the Company by the weighted average number of ordinary shares in issue during the year.

There is no difference between the basic and diluted earnings per share as the Bank has no share options or convertible debt outstanding.

	2005 € 000	2004 € 000
Profit attributable to equity holders of the Bank (€ thousands)	72,585	31,881
Weighted average number of ordinary shares in issue (thousands)	452,500	315,000
Basic earnings per share (expressed in € per share)	0.16	0.10
Diluted earnings per share (expressed in € per share)	0.16	0.10

### 14. Cash and balances with central banks

	2005 € 000	2004 € 000
Mandatory reserve deposits with central banks	8,552	2,821
	<b>8,552</b>	<b>2,821</b>

Mandatory reserve deposits are not available for use in the Bank's day to day operations.

### 15. Loans and advances to banks

	2005 € 000	2004 € 000
Public sector loans	4,874,136	3,612,436
Cash collateral	768,490	416,610
Other loans and advances	8,263,550	5,780,469
	<b>13,906,176</b>	<b>9,809,515</b>
Of which due from Group companies	8,253,247	5,525,245

## 16. Derivative financial instruments

	2005 € 000	2004 € 000
<b>Assets</b>		
Derivatives	1,378,388	1,180,099
	<b>1,378,388</b>	<b>1,180,099</b>
<b>Liabilities</b>		
Derivatives	2,773,987	1,725,903
	<b>2,773,987</b>	<b>1,725,903</b>

Derivatives are contracts or agreements whose values are determined on the basis of changes in an underlying variable, such as interest rates, foreign exchange rates, securities prices, financial and commodity indices or other variables. The timing of cash receipts and payments for derivatives is generally determined by contractual agreement. Derivatives are either standardised contracts traded on exchanges or over-the-counter (OTC) contracts agreed individually by the parties to the contract. Futures and certain options are examples of standard exchange-traded derivatives. Forwards, swaps, and other option contracts are examples of OTC derivatives. OTC derivatives are not freely tradable. In the normal course of business, however, they may be terminated or assigned to another counterparty if the current party to the contract agrees.

The Bank uses derivative financial instruments primarily as a means of hedging the risk associated with asset/liability management in the context of interest bearing transactions. Interest rate derivatives are primarily entered into to hedge the fair value interest rate risk in fixed-rate available-for-sale securities, loans extended, and debt securities in issue. Derivatives are also entered into, to a smaller extent, for the purpose of hedging foreign currency risks. Foreign exchange risks are primarily hedged by means of suitable fair value hedges for available-for-sale securities, loans extended and debt securities in issue. However, some derivatives used for risk management purposes do not qualify for hedge accounting and are therefore classified as part of the 'trading portfolio' in the Bank's financial statements.

Derivatives used by the Bank include:

- Interest rate and currency swaps
- Interest rate options
- Forward foreign exchange contracts

Interest rate swaps involve the exchange of fixed and variable rate interest payments between two parties at specified times based on a common nominal amount and maturity date. The nominal amounts are normally not exchanged.

Cross currency swaps have nominal amounts in two different currencies. The interest is paid in these two currencies. An exchange of the nominal amount often takes place at the beginning and at the end of the contract.

Interest rate options are contracts that allow the purchaser to enter into contracts on financial instruments or to buy or sell an underlying variable, at a specified price at a specified point in time. The option writer is obligated to buy, sell or enter into a financial instrument, if the purchaser chooses to exercise the option. Option contracts purchased or written by the Bank include caps and floors, which are interest rate hedging instruments, as the agreed payment covers the difference in

interest between the agreed interest rate and the market rate. Exposure to current and future movements in interest rates and the ability of the counterparties to meet the terms of the contracts represent the primary risks associated with interest rate options.

Forward foreign exchange contracts involve an agreement to exchange two currencies at a specific price and date agreed in advance. Exposure to changes in foreign currency exchange rates and foreign interest rates and the counterparty default risk are the primary risks associated with forward foreign exchange contracts.

The notional amounts of certain types of financial instruments provide a basis for comparison with instruments recognised on the balance sheet but 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 or price risks. The derivative instruments become favourable (assets) or unfavourable (liabilities) as a result of fluctuations in market factors such as interest rates or foreign exchange rates relative to their terms. The aggregate contractual or notional amount of derivative financial instruments on hand, the extent to which instruments are favourable or unfavourable, and thus the aggregate fair values of derivative financial assets and liabilities, can fluctuate significantly from time to time. The fair values of derivative instruments held are set out below.

	2005			2004		
	Fair values			Fair values		
	Contract/ notional amount € 000	Assets € 000	Liabilities € 000	Contract/ notional amount € 000	Assets € 000	Liabilities € 000
<b>At 31 December</b>						
<b>1) Derivatives held for trading</b>						
Interest rate and currency swaps	21,714,614	35,469	130,534	17,953,338	40,373	110,234
Foreign exchange contracts	346,011	2,976	628	154,964	123	2,829
<b>Total derivative assets/liabilities held for trading</b>	<b>22,060,625</b>	<b>38,445</b>	<b>131,162</b>	<b>18,108,302</b>	<b>40,496</b>	<b>113,063</b>
<b>2) Derivatives held for hedging</b>						
a) Derivatives designated as fair value hedges						
Interest rate and currency swaps	63,150,288	1,339,943	2,625,949	40,754,652	1,139,603	1,539,664
	63,150,288	1,339,943	2,625,949	40,754,652	1,139,603	1,539,664
b) Derivatives designated as cash flow hedges						
Interest rate and currency swaps	437,183	-	16,876	436,103	-	73,176
	437,183	-	16,876	436,103	-	73,176
<b>Total derivative assets/liabilities held for hedging</b>	<b>63,587,471</b>	<b>1,339,943</b>	<b>2,642,825</b>	<b>41,190,755</b>	<b>1,139,603</b>	<b>1,612,840</b>
<b>Total derivative assets/liabilities</b>	<b>85,648,096</b>	<b>1,378,388</b>	<b>2,773,987</b>	<b>59,299,057</b>	<b>1,180,099</b>	<b>1,725,903</b>

The Bank does not engage in proprietary derivative trading. All derivatives are taken out for risk management purposes. The directors consider all derivatives to be economic hedges. However, certain derivatives entered into by the company do not meet the onerous hedge accounting requirements of IAS 39 and consequently are required to be classified in the financial statements as derivatives held for trading.

## 17. Loans and advances to customers

	2005 € 000	2004 € 000
Public sector loans	38,963,834	26,678,074
Term deposits	55,574	70,392
	<b>39,019,408</b>	<b>26,748,466</b>
Of which due from Group companies	-	-

## 18. Investment securities

	2005 € 000	2004 € 000
<b>Securities available-for-sale</b>		
Debt securities – at fair value :		
– listed	509,618	240,259
– unlisted	3,488,175	1,503,778
<b>Total securities available-for-sale</b>	<b>3,997,793</b>	<b>1,744,037</b>

Net gains on disposal of investment securities for the year amounted to € 24,853 thousand (2004: € 4,870 thousand).

The movement in investment securities (including investment securities reported under pledged assets) may be summarised as follows:

	Available-for-sale € 000
<b>At 1 January 2005</b>	<b>2,247,663</b>
Exchange differences on monetary assets	99,575
Additions	2,597,635
Disposals (sale and redemption)	-1,035,067
Gains/(losses) from changes in fair value	87,987
<b>At 31 December 2005</b>	<b>3,997,793</b>

The investment securities balance at 31 December is analysed by counterparty risk below:

	2005 € 000	2004 € 000
Central government bonds	3,215,619	1,182,161
Local government bonds	782,174	561,876
<b>Total</b>	<b>3,997,793</b>	<b>1,744,037</b>

## 19. Pledged assets

	2005 € 000		2004 € 000	
	Asset	Related liability	Asset	Related liability
Investment securities pledged	-	-	503,626	431,354
<b>Total</b>	<b>-</b>	<b>-</b>	<b>503,626</b>	<b>431,354</b>

Pledged assets consist of assets pledged under repurchase agreements.

In accordance with the accounting policy for sale and repurchase agreements (see page 20), the Bank has classified assets sold subject to repurchase agreements as a security interest, hence the term pledged assets. However, legally the 'pledged assets' operate by way of a legal transfer and not a security interest

The investment securities balance at 31 December included under pledged assets is analysed by counterparty risk below:

	2005 € 000	2004 € 000
Government bonds	-	503,626
<b>Total</b>	<b>-</b>	<b>503,626</b>

## 20. Deposits from banks

	2005 € m	2004 € m
Term deposits	482,447	525,915
Call deposits	-	9,439
Repurchase agreements	-	431,354
Other liabilities	17,664,129	13,672,208
	<b>18,146,576</b>	<b>14,638,916</b>
Of which due to Group companies	17,475,578	13,585,805

## 21. Due to customers

	2005 € 000	2004 € 000
Term deposits	-	14,267
Repurchase agreements	-	55,292
	-	<b>69,559</b>
Of which due to Group companies	-	-

## 22. Debt securities in issue

	2005 € 000	2004 € 000
Public sector covered bonds	36,518,796	22,867,518
	<b>36,518,796</b>	<b>22,867,518</b>

Included in the debt securities in issue are the following benchmark issues as at 31 December 2005:

ISIN code	Coupon	Year of issue	Maturity date	Currency	Nominal
DE0007009482	3.875%	2003	July 15, 2013	EUR	3,500
DE0007763757	3.250%	2003	April 15, 2008	EUR	5,000
DE0008026071	3.625%	2003	October 29, 2008	USD	1,250
DE000A0ACCT0	2.875%	2004	January 22, 2007	EUR	5,000
DE000A0D24M9	4.250%	2005	August 16, 2010	USD	1,250
DE000A0DALH4	4.375%	2004	January 15, 2015	EUR	3,000
DE000A0DXH13	3.250%	2005	February 15, 2012	EUR	3,000
DE000A0GHGNO	4.875%	2005	October 28, 2015	USD	1,000

## 23. Other borrowed funds

	2005 € 000	2004 € 000
Subordinated debt	256,492	206,385
Of which due to Group companies	256,492	206,385

The other borrowed funds are subordinated in right of payment to other creditors of the Bank and rank in priority to the equity holders of the Bank.

The subordinated debt as at 31 December 2005 consists of the following:

- € 50m floating rate loan from DEPFA Finance NV, maturity 2030
- € 60m fixed rate loan from DEPFA Finance NV, maturity 2028
- € 75m floating rate loan from DEPFA Finance NV, maturity 2025
- € 70m floating rate loan from DEPFA BANK plc, maturity 2029

## 24. Other liabilities

	2005 € 000	2004 € 000
Creditors and accruals	15,691	12,867
	<b>15,691</b>	<b>12,867</b>
Of which due to Group companies	14,193	12,087

## 25. Deferred taxation

Deferred income taxes are calculated on all temporary differences under the liability method using the effective tax rate in Ireland.

Deferred tax balances consist of the following

	2005 € 000	2004 € 000
Deferred tax liabilities	2,405	2,487

The movement on the deferred income tax account is as follows:

	2005 € 000	2004 € 000
At 1 January	-2,487	-2,159
Income statement charge	-82	682
Fair value measurement on AFS securities	164	-1,010
Fair value measurement on cash flow hedges	-	-
<b>At 31 December</b>	<b>-2,405</b>	<b>-2,487</b>

Deferred income tax assets and liabilities are attributable to the following items:

	2005 € 000	2004 € 000
Fair value hedges	330	412
Unrealised gains/losses on AFS securities	-2,735	-2,899
Cash flow hedges	-	-
	<b>-2,405</b>	<b>-2,487</b>

The deferred tax charge in the income statement comprises the following temporary differences:

	2005 € 000	2004 € 000
Fair value hedges	-82	682
Cash flow hedges	-	-
	<b>-82</b>	<b>682</b>

Deferred income tax assets and liabilities are offset when there is a legally enforceable right to offset current tax assets against current tax liabilities and when the deferred income taxes relate to the same fiscal authority.

## 26. Share capital

The authorised share capital at year end was 1,000,000,000 ordinary shares of € 1 each. All shares were issued at par and are fully paid .

	2005 € 000	2004 € 000
At January 1	395,000	235,000
Shares issued at par	115,000	160,000
<b>At December 31</b>	<b>510,000</b>	<b>395,000</b>

## 27. Retained earnings

	2005 € 000	2004 € 000
At January 1	48,363	16,482
Profit for year	72,585	31,881
Dividends	-49,913	-
<b>At December 31</b>	<b>71,035</b>	<b>48,363</b>

## 28. Other reserves

	2005 € 000	2004 € 000
Unrealised gains/losses from cash flow hedges	-	-
Unrealised gains/losses from available-for-sale investment securities	19,141	20,293
<b>Total other reserves at 31 December</b>	<b>19,141</b>	<b>20,293</b>

	2005 € 000	2004 € 000
<b>Unrealised gains/losses from cash flow hedges</b>		
At January 1	-	-
Net gain/loss from changes in fair value, net of tax	49	-25
Net gains/losses transferred to net profit, net of tax	-49	25
<b>At December 31</b>	<b>-</b>	<b>-</b>

	2005 € 000	2004 € 000
<b>Unrealised gains/losses from available-for-sale investment securities</b>		
At January 1	20,293	16,997
Net gain/loss from changes in fair value, net of tax	22,401	3,803
Net gains/losses transferred to income statement, net of tax	-23,553	-507
<b>At December 31</b>	<b>19,141</b>	<b>20,293</b>

## 29. Dividends per share

Final dividends are not accounted for until they have been ratified at the Annual General Meeting.

At the Annual General Meeting on 12 April 2006, a dividend in respect of 2005 of € 71,035 thousand (2004: actual dividend € 49,913 thousand) will be proposed. The financial statements for the year ended 31 December 2005 do not reflect this resolution, which will be accounted for in shareholders' equity as an appropriation of retained profits in the year ending 31 December 2006.

## 30. Cash and cash equivalents

For the purposes of the cash flow statement, cash and cash equivalents comprise the following balances with less than three months' maturity from the date of acquisition:

	2005 € 000	2004 € 000
Loans and advances to banks	10,298	26,012

## 31. Related party transactions

### Key Management Compensation

	2005 € 000	2004 € 000
For services as a director	10,000	10,000
Salaries and other emoluments	1,572,445	3,433,496
	<b>1,582,445</b>	<b>3,443,496</b>

Key management consists solely of directors of the Bank.

Directors' emoluments shown comprise all fees, salaries, pension contributions, shares vested on 16 February 2006 and other benefits and emoluments paid to directors.

The Group established an Incentive Compensation Programme in 2002 under which the Group Compensation Committee is entitled to pay an annual cash bonus and to make awards of restricted shares to employees and directors of the Group.

In conjunction with the formation of the Incentive Compensation Programme, the Group established a Trust that is used to purchase shares of DEPFA BANK plc with funds provided by the Group.

The programme authorises the granting of restricted shares to be held by the Trust until vesting conditions specified by the Group are satisfied. The restricted shares carry no voting rights but are entitled to receive dividends as and when declared. Restricted shares are awarded for no consideration and are subject only to continued employment over the three year vesting period. Dividends declared during the vesting period will be used to purchase additional shares in DEPFA BANK plc which will vest three years from the date of the award.

On 16 February 2003, 31 January 2004 and 15 February 2005, the Group awarded 204,330 shares to the directors of the Bank under the Incentive Compensation Programme. These shares vest over a three year period. 69,274 shares vested on 16 February 2006.

The interests of the directors and secretary, in office as at 31 December 2005, and of their spouses and minor children in the shares of the Bank or Group undertakings are set out in the table below.

Shares in DEPFA BANK plc	12 April 2006 Shares	31 December 2005 Shares	31 December 2004 Shares
<b>Directors:</b>			
Mr. B. Heide-Ottosen	33,333	-	-
Mr. M. Deeny	3,531	3,531	4,301
Mr. B. Farrell	22,940	22,940	22,940
Ms. J. Hoggett	-	-	-
Dr. T.P. Carey	-	-	-
Prof. Dr. F. Ruane	-	-	-
<b>Company secretary:</b>			
Mr. N. Kavanagh	-	-	1,000

There were no contracts of any significance in relation to the business of DEPFA BANK plc, or any of its subsidiaries, in which the directors had any interest as defined in the Companies Act 1990, at any time during the year ended 31 December 2005.

There are no loans to directors at 31 December 2005 (31.12.2004: nil).

	2005 € 000	2004 € 000
Interest income	131,759	69,548
Interest expense	347,436	232,773
Gains less losses from financial assets	10,671	-
Other operating income	1,450	604
Administrative expenses	4,315	6,959
Other operating expenditure	148	-

The amounts above arise on intercompany borrowings and lending, and transfers of assets between the Bank and other Group entities, as well as recharges for certain services provided.

## 32. Characteristics of the asset pool as at 31 December 2005

The following table analyses the countries where the public credit assets included in the pool are located, the number of public credit assets located in these countries, the nominal amount of the public credit assets in Euro and, based on the amount of those assets outstanding, the percentage of public credit assets located in those countries. The amount is the nominal amount of the asset adjusted for any unamortised premium or discount.

Country	Number of assets	€ 000	Percentage
Italy	82	8,372,057	21.1%
Spain	160	6,977,804	17.6%
Germany	93	6,779,043	17.1%
USA	83	3,120,156	7.9%
France	77	2,148,001	5.4%
Belgium	17	1,707,805	4.3%
Greece	9	1,444,409	3.6%
Portugal	15	1,283,194	3.2%
Austria	13	1,237,611	3.1%
Finland	56	1,187,110	3.0%
Canada	15	1,009,007	2.5%
Netherlands	137	983,064	2.5%
Switzerland	15	948,606	2.4%
Britain	12	459,436	1.2%
Sweden	11	418,128	1.1%
Hungary	4	408,394	1.0%
Japan	5	312,561	0.8%
Iceland	13	291,447	0.7%
Supranational	6	157,619	0.4%
Poland	3	156,913	0.4%
Ireland	21	150,398	0.4%
Denmark	3	53,849	0.1%
Slovenia	1	50,000	0.1%
Malta	1	4,651	0.1%
<b>Total</b>	<b>852</b>	<b>39,661,263</b>	<b>100%</b>

### 33. Commitments

	2005 € 000	2004 € 000
Commitments for public sector loans	1,303,834	1,031,711

### 34. Segmental reporting

The Bank's income and assets are entirely attributable to public sector financing. The Bank is solely located in Ireland. Therefore no segmental report is presented.

### 35. Ultimate parent company

DEPFA BANK plc, a company registered in the Republic of Ireland, is the ultimate parent company of the Bank. The largest and smallest group into which the results of the Bank are consolidated is that headed by DEPFA BANK plc.

### 36. Events after the balance sheet date

There have been no significant events after the balance sheet date which require disclosure.

### 37. Approval of financial statements

The financial statements were approved by the directors on 12 April 2006.

**DEPFA ACS BANK**

1 Commons Street  
Dublin 1, Ireland

Phone +353 1 792-2222

Fax +353 1 792-2211

E-mail: [info@depfa.com](mailto:info@depfa.com)

Internet: [www.depfa.com](http://www.depfa.com)



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