

Note 1 - Accounting principles

SpareBank 1 SMN prepares and presents its quarterly accounts in compliance with the Stock Exchange Regulations, Stock Exchange Rules and International Financial Reporting Standards (IFRS) approved by EU, including IAS 34, Interim Financial Reporting. The quarterly accounts do not include all the information required in a complete set of annual financial statements and should be read in conjunction with the annual accounts for 2017. The Group has in this quarterly report used the same accounting principles and calculation methods as in the latest annual report and accounts, except implementing IFRS 9 as described below.

IFRS 9

IFRS 9 Financial instruments deals with recognition, classification, measurement and derecognition of financial assets and liabilities as well as hedge accounting. IFRS 9 is applicable from 1 January 2018 and is approved by the EU.

Detailed information about the implementation of IFRS 9 in SpareBank 1 SMN can be found in note 2 and 45 in the annual report for 2017.

As allowed in the transition rules in IFRS 9, the bank has chosen not to adjust the comparative figures, and these have been presented in line with previous accounting principles as described in the annual report for 2017. Adjustments in amounts recorded at the transition date 1. January 2018 has been made against equity, and new disclosures in line with IFRS 7 has been presented. Disclosure information using previous principles are the same as presented previous periods.

Classification and measurement

Financial assets

Under IFRS 9 financial assets are classified in three measurement categories: fair value with changes in fair value reported in profit/loss (FVPL), fair value with changes in fair value reported in other comprehensive income (OCI), and amortised cost. The measurement category is determined upon first-time recognition of the particular asset. For financial assets a distinction is drawn between debt instruments and equity instruments. The classification of financial assets is determined on the basis of contractual terms and conditions for the financial assets and the business model used to manage the portfolio of which the assets are a part.

Financial assets that are debt instruments

Debt instruments with contractual cash flows that are only payment of interest and principal on given dates and which are held in a business model whose purpose is to receive contractual cash flows shall in principle be measured at amortised cost. Instruments with contractual cash flows that are only payment of interest and principal on given dates and which are held in a business model whose purpose is both to receive contractual cash flows and sales shall in principle be measured at fair value with changes over OCI, with interest income, currency conversion effects and any write-downs reported in ordinary profit/loss. Fair value changes over OCI shall be reclassified to profit/loss upon the sale or other disposal of the assets.

Other debt instruments shall be measured at fair value with changes reported in profit/loss. This applies to instruments with cash flows that are not only payment of normal interest (time value of money, credit margin and other normal margins related to loans and receivables) and principal, and instruments held in a business model whose main purpose is not that of receiving contractual cash flows. Instruments that should basically be measured at amortised cost or at fair value with changes through OCI can be designated to be measured at fair with changes through profit or loss if this eliminates or significantly reduces an "accounting mismatch".

Derivatives and investments in equity instruments

All derivatives shall be measured at fair value with changes reported in profit/loss, but derivatives designated as hedging instruments shall be accounted for in keeping with the principles for hedge accounting. Investments in equity instruments shall be measured in the balance sheet at fair value. Value changes shall as a main rule be reported in ordinary profit/loss, but an equity instrument which is not held for trading purposes and is not a contingent consideration following a business combination can be designated as measured at fair value with changes reported in OCI. Where equity instruments are designated at fair value with value changes reported in OCI, ordinary proceeds shall be reported in profit/loss, whereas value changes shall not be reported in profit/loss either on an ongoing basis or upon disposal.

Financial liabilities

Financial liabilities shall continue to be measured at amortised cost with the exception of financial derivatives measured at fair value, financial instruments forming part of a trading portfolio and financial liabilities accounted for at fair value with value changes recognised in profit/loss.

Loan impairment write-downs

Under IFRS 9 loss provisions shall be recognised based on expected credit loss (ECL). Measurement of the provision for expected loss depends on whether credit risk has increased significantly since first-time recognition. Upon first-time recognition, and when credit risk has not increased significantly since first-time recognition, provision shall be made for a 12-month expected loss. If credit risk has risen significantly, provision shall be made for expected loss across the entire life. The methodology in the IFRS 9 standard entails somewhat

larger volatility in write-downs, and write-downs are expected to be made at an earlier stage than under current practice. This will be particularly noticeable at the start of a cyclical downturn.

Further description of the bank's impairment write-down model

Loss estimates are prepared quarterly, and build on data in the data warehouse which has historical accounting and customer data for the entire credit portfolio. The Bank uses three macroeconomic scenarios to consider the non-linear aspects of expected credit losses. The different scenarios are used to adjust the input parameters for calculating expected credit loss, and an probability weighted average expected calculated loss of the scenarios is recorded as the loss.

Loss estimates are computed based on 12-month and lifelong probability of default (PD), loss given default (LGD) and exposure at default (EAD). The data warehouse contains historical data for observed PD and observed LGD. This is the basis for preparing good estimates for the future values for PD og LGD. In keeping with IFRS 9 the bank groups its loans in three stages.

Stage 1:

This is the starting point for all financial assets covered by the general loss model. All assets that do not have significantly higher credit risk than at first-time recognition receive a loss provision corresponding to 12 months' expected loss. All assets that are not transferred to stage 2 or 3 reside in this category.

Stage 2:

Stage 2 of the loss model encompasses assets that show a significant increase in credit risk since first-time recognition, but where objective evidence of loss is not present. For these assets a provision for expected loss over the entire lifetime is to be made. In this group we find accounts with a significant degree of credit deterioration, but which at the balance sheet date belong to customers classified as performing. As regards delineation against stage 1, the bank defines 'significant degree of credit deterioration' by taking a basis in whether the exposure's calculated probability of default shows a significant increase. SpareBank 1 SMN has decided to utilise both absolute and relative changes in PD as criteria for transfer to stage 2. The most important factor for a significant change in credit risk is the quantitative change in PD on the period end compared to the PD at first time recognition. A change in PD by more than 150 per cent is considered to be a significant change in credit risk. The change will have to be over 0.6 percentage points. In addition, customers with payments 30 days past due will be transferred to stage 2. A qualitative assessment is also done when engagements have been put on watch list.

Stage 3:

Stage 3 of the loss model encompasses assets that show a significant increase in credit risk since loan approval and where there is objective evidence of loss at the balance sheet date. For these assets a provision shall be made for expected loss over the entire lifetime. These are assets which under previous rules were defined as defaulted and written down.

SpareBank 1 SMN calculates the provision for credit loss for assets in stage 1 and 2 in accordance with IFRS 9 as the net present value of the exposure (EAD) multiplied by probability of default (PD) multiplied by loss given default (LGD). SpareBank 1 SMN has grouped the loans in three portfolios and make projections for a period of five years for each portfolio.