Note 2 - Critical estimates and assessment concerning the use of accounting principles

When it prepares the consolidated accounts the management team makes estimates, discretionary assessments and assumptions which influence the application of accounting principles. This accordingly affects recognised amounts for assets, liabilities, revenues and expenses. Last year's annual accounts give a closer explanation of significant estimates and assumptions in Note 3 Critical estimates and assessments concerning the use of accounting principles.

Pensions

Sparebank1 SMN Group has one pension arrangement; defined contribution plan. For a further description of the pension scheme, see note 25 in the 2019 annual report.

The group's pension liabilities are accounted for under IAS 19R. Estimate variances are therefore directly reflected in equity capital and are presented under other comprehensive income. It was decided to terminate the defined benefit scheme at a board meeting on 21 October 2016. Employees on this scheme transferred to the defined contribution scheme from 1 January 2017, and received a paid-up policy showing rights accumulated under the defined benefit scheme. Paid-up policies are managed by the pension fund, which has been a paid-up pension fund as from 1 January 2017. A framework agreement has been established between SpareBank 1 SMN and the pension fund which covers funding, asset management etc. In view of the responsibility still held by SpareBank 1 SMN, future liabilities will need to be incorporated in the accounts. The board of the pension fund is required to be composed of representatives from the Group and participants in the pension schemes in accordance with the articles of association of the pension fund.

A new calculation of the Group's pension liabilities has been carried out as per 30 June 2020:

Actuarial assumptions	**31 Dec 2019**	**1 January 2019**	**30 June 2020**
Discount rate	2,30 %	2,30 %	1,40 %
Expected rate of return on plan assets	2,30 %	2,30 %	1,40 %
Expected future wage and salary growth	2,00 %	2,00 %	2,00 %
Expected adjustment on basic amount (G)	2,00 %	2,00 %	2,00 %
Expected increase in current pension	0,00 %	0,00 %	0,00 %
Employers contribution	19,10 %	19,10 %	19,10 %

Demographic assumptions:	
Mortality base table	K2013 BE
Disability	IR73
Voluntary exit	2% to 50 years, 0% after 50 years

Movement in net pension liability in the balance sheet Group (NOKm)	**Funded**	**Unfunded**	**Total**
Net pension liability in the balance sheet 1.1	-148	16	-132
OCI accounting 1 Jan	40	0	40
OCI accounting 31 December	26	-4	23
Net defined-benefit costs in profit and loss account	0	0	0
Paid in pension premium, defined-benefit plan	-	-1	-1
Net pension liability in the balance sheet 30 June 2020	**-83**	**12**	**-72**

Net pension liability in the balance sheet Group (NOKm)	30 June 2020	31 Dec 2019
Net present value of pension liabilities in funded schemes	681	608
Estimated value of pension assets	-755	-743
Net pension liability in the balance sheet before employer's contribution	-74	-135
Employers contribution	2	3
Net pension liability in the balance sheet	**-72**	**-132**

Pension cost Group (NOKm)	30 June 2020	31 Dec 2019
Present value of pension accumulated in the year	0	0
Net interest income	-0	-4
Net pension cost related to defined plans, incl unfunded pension commitment	-0	-4
Empolyer's contribution subject to accrual accounting	0	0
Cost of defined contribution pension and early retirement pension scheme	52	108
Total pension cost for the period	**52**	**105**

Investment held for sale

SpareBank 1 SMN's strategy is that ownership duse to defaulted exposures should at the outset be of brief duration, normally not longer than one year. Investments are recorded at fair value in the Parent Bank's accounts, and is classified as investment held for sale.

2020 Q2 (NOKm)	Assets	Liabilities	Revenue	Expenses	Profit	Ownership
Mavi XV AS Group	42	1	2	2	0	100 %
Total Held for sale	**42**	**1**	**2**	**2**	**0**	

Losses on loans and guarantees

For a detailed description of the Bank's model for expected credit losses, refer to note 2 and 3 in the annual accounts for 2019. In the first quarter 2020 some changes were made in the input in the credit loss model as a result of changed expectations due to the corona situation. The crisis and the significant increase in macroeconomic uncertainty have made the assessments extra demanding. We are in the early stages of the crisis and the consequences for the bank's customers and the industries we are exposed to are difficult to estimate. The regulators have emphasized the importance of focusing on the expected long-term effects of the crisis and this has also been the bank's focus.

In the first quarter 2020 the bank changed the assumptions for the base scenario in a negative direction. This has been continued in the second quarter 2020.

The development in the base scenario is prepared using adjustment factors where the development in the business cycle is projected by assumptions about how much the probability of default (PD) or loss of default (LGD) will increase or decrease compared to the base scenario in a five-year period. We expect increased losses related to debtors that have a demanding starting point before the crisis - typically debtors in stage 2. We have therefore chosen to increase the trajectories for PD and LGD as well as reduce expected repayments in the base scenario, especially from year 2 onwards, since this will affect expected losses mainly for debtors in stage 2. To adjust for migration into stage 2, PD and LGD estimates are also increased in the first year. No first year repayments are assumed for all portfolios in all scenarios.

The effect of changes in input assumptions is shown as "Effect of changed assumptions in ECL model" in note 7. The effect is NOK 92 million for the Bank and 88 million for the Group.

Sensitivity

The first part of the table below show total calculated expected credit loss as of 30 june 2020 in each of the three scenarios, distributed in the portfolios Retail Market, Corporate Market and offshore and agriculture, which adds up to parent bank. In addition the subsidiary SpareBank 1 Finans Midt-Norge is included. ECL for the parent bank and the subsidiary is summed up in the coloumn "Group"

The second part of the table show the ECL distributed by portfolio using the scenario weight applied, in addition to a alternative weighting where downside scenaro weight has been doubled. The weights used is different for the offshore portfolio.

If the downside scenario’s probability were doubled at the expense of the baseline scenario at the end of june 2020, this would have entailed an increase in loss provisions of NOK 83 million for the parent bank and NOK 89 million for the group*⁾.

Portfolio	Corporate excl offshore/ Agriculture	Retail Market	Offshore	Agriculture	Total parent	SB 1 Finans MN	Group*)
ECL expected scenario	368	113	779	42	1.302	52	1.354
ECL downside scenario	652	331	972	82	2.036	129	2.165
ECL upside scenario	268	43	681	24	1.016	37	1.054
ECL with scenario weights used 80/10/10	387	128	-	44	-	60	-
ECL with scenario weights used 70/15/15	-	-	793	-	0	0	0
Total ECL used	**387**	**128**	**793**	**44**	**1.352**	**60**	**1.414**
ECL alternative scenario weights 70/20/10	415	150	-	48	-	66	-
ECL alternative scenario weights 55/30/15	-	-	822	-	-	-	-
Total ECL alternative weights (double downside)	**415**	**150**	**822**	**48**	**1.435**	**66**	**1.503**
Change in ECL if alternative weights were used	**28**	**22**	**29**	**8**	**83**	**6**	**89**

* in addition, an ECL provision has been included for the group for the subsidiary SpareBank 1 SMN Spire Finans of NOK 2 million, which is not specified in the table.

The table reflects that there are some significant differences in underlying PD and LGD estimates in the different scenarios and that there are differentiated levels and level differences between the portfolios. At group level, the ECL in the upside scenario, which largely reflects the loss and default picture in recent years, is about 80 per cent of the ECL in the expected scenario. The downside scenario gives about double the ECL than in the expected scenario. Applied scenario weighting gives about 4 percent higher ECL than in the expected scenario.