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.

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 2021.

In 2020 and 2021 a number of changes were made in inputs to the bank's credit loss model in light of the increased uncertainty triggered by the Covid-19 situation. In the present quarter, increased macroeconomic uncertainty due to the war in Ukraine, a strong increase in energy and commodity prices, supply chain challenges and prospects of lasting higher inflation and interest rate levels have made the assessments extra demanding. The supervisory authorities have underscored the importance of focusing on the expected long-term effects of the crisis, and this has been the focus in the bank's assessments.

In 2020 the bank revised its assumptions for the baseline scenario in a negative direction. This was continued through 2021. The bank's exposure to the hotel and tourism industry, including commercial property with revenues deriving mainly from that industry, was hived off into a separate portfolio with its own assessments of PD and LGD trajectories and separate scenarios and weighting of the latter to reflect the portfolio's vulnerability to the effects of Covid. In addition, the entire portfolio was assigned to stage 2 or 3.

The key assumptions per scenario are projected trajectories for the probability of default (PD) and loss given default (LGD) along with a probability weighting for the individual scenario. In the assessments for 2020/2021, expected effects of the Covid pandemic were linked to debtors who were in a demanding position prior to the crisis – typically debtors in stage 2. We therefore chose to increase the trajectories for PD and LGD as well as reduce expected payments in the baseline scenario especially for year 2 onwards since this will mainly affect expected losses for stage 2 debtors. To allow for migration to stage 2, the PD and LGD estimates were also increased in the first year. In addition, an assumption of no first-year repayments is made for all portfolios in the downside scenario. However, experience shows the effects of the Covid pandemic to be significantly smaller than expected owing to the government measures put in place, and we no longer see a basis for add-ons to the baseline trajectories due to the Covid pandemic.

The scenario weighting applied was also revised in 2020 to reflect a further increase in uncertainty. For business and industry including offshore, along with agriculture, the downside scenario was revised from a 10 per cent probability weighting to a weighting of 20 per cent probability. For the personal market the weighting of the downside scenario was revised from 10 to 15 per cent. In the first quarter of 2022 the downside scenario weighting was increased further in the agriculture and 'other corporate' (corporate exc. offshore and hotels /tourism) portfolios to 25 per cent to take into account increased uncertainty due to the war in Ukraine and generally greater uncertainty with regard to future economic growth.

The effect of the revision of assumptions in 2022 is shown in the line "Changes due to changed input assumptions in the credit loss model" in note 7. Removal of the add-on in the baseline scenario for the corporate portfolio (with the exception of hotels/tourism and offshore where special assumptions are employed) pulls in the direction of reduced write-downs, while increased weight given to a low scenario pulls in the opposite direction. Altogether this amounts to NOK 59 million for the bank and NOK 63 million for the group in terms of reduced write-downs.

Sensitivity
The first part of the table below show total calculated expected credit loss as of 31 mars 2022 in each of the three scenarios, distributed in the portfolios Retail Market, Corporate Market and offshore, tourism 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.

If the downside scenario's probability were doubled at the expense of the baseline scenario at the end of March 2022, this would have entailed an increase in loss provisions of NOK 355 million for the parent bank and NOK 363 million for the group.

	CM (excl offshore and agriculture)	RM	Offshore	Tourism	Agriculture	Total parent	SB 1 Finans MN	Group
ECL base case	412	64	408	30	29	943	51	994
ECL worst case	1,025	278	1,037	90	130	2,560	133	2,693
ECL best case	360	31	326	12	18	746	34	780
	-							
ECL with scenario weights used 80/10/10		-	-	-		-	57	57
ECL with scenario weights used 60/25/15	558	-		-	53	610	-	610
ECL with scenario weights used 65/20/15			521			521		521
ECL with scenario weights used 60/30/10	-	-	-	46	-	46	-	46
ECL with scenario weights used 70/15/15	-	91	-	-	-	91	-	91
Total ECL used	**558**	**91**	**521**	**46**	**53**	**1,269**	**57**	**1,326**
ECL alternative scenario weights 70/20/10	-	-	-	-	-	-	65	65
ECL alternative scenario weights 35/50/15	711	-	-	-	78	789	-	789
ECL alternative scenario weights 45/40/15	-	-	647	-	-	647	-	647
ECL alternative scenario weights 30/60/10				64		64		64
ECL alternative scenario weights 55/30/15	-	123	-		-	123	-	123
Total ECL alternative weights	**711**	**123**	**647**	**64**	**78**	**1,623**	**65**	**1,688**
Change in ECL if alternative weights were used	**153**	**32**	**126**	**18**	**25**	**355**	**8**	**363**

The Tourism portfolio includes commercial real estate with more than 50% of the income from actors in hotels and tourism companies.

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 30 percent higher ECL than in the expected scenario.