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 22 in the 2021 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 not been carried out as per 30 June 2022.

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.

	Assets	Liabilities	Revenue	Expenses	Profit	Ownership
Mavi XV AS Group	111	1	5	-6	-1	100 %
Total Held for sale	**111**	**1**	**5**	**-6**	**-1**	

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 to the input in the credit loss model in light of the increased uncertainty triggered by the Covid-19 situation. In first half of 2022, 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 bank has been focusing on the expected long-term effects of the crisis.

In 2020, the bank revised its assumptions for the base scenario in a negative direction. This was continued through 2021. The bank's exposure to hotels and tourism, including commercial real estate with the income mainly towards this industry, is separated into a separate portfolio with its own assessments of PD and LGD courses as well as special scenarios and weighting of these to reflect this portfolio's exposure to the effects of corona. In addition, this entire portfolio is included in stage 2 or 3.

The central drivers of expected losses in the individual scenarios are projections of trajectories for the probability of default (PD) and loss given default (LGD). In addition, the expected loss will be affected by the 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 applied weighting has been continued in the second quarter 2022.

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 43 million for the bank and NOK 57 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 30 June 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 June 2022, this would have entailed an increase in loss provisions of NOK 261 million for the parent bank and NOK 269 million for the group.

	CM (excl offshore and agriculture)	**RM**	**Offshore**	**Tourism**	**Agriculture**	**Total parent**	**SB 1 Finans MN**	**Group**
ECL base case	427	68	276	22	32	825	51	876
ECL worst case	994	251	517	80	128	1,969	133	2,103
ECL best case	357	30	162	9	17	575	34	609
	-							
ECL with weights used 80/10/10		-	-	-		-	58	58
ECL with weights used 60/25/15	558	-		-	54	612	-	612
ECL with weights used 65/20/15			306			306		306
ECL with weights used 60/30/10	-	-	-	38	-	38	-	38
ECL with weights used 70/15/15	-	89	-	-	-	89	-	89
Total ECL used	**558**	**89**	**306**	**38**	**54**	**1,045**	**58**	**1,103**
ECL alternative weights 70/20/10	-	-	-	-	-	-	66	66
ECL alternative weights 35/50/15	700	-	-	-	78	778	-	778
ECL alternative weights 45/40/15	-	-	355	-	-	355	-	355
ECL alternative weights 30/60/10				56		56		56
ECL alternative weights 55/30/15	-	117	-		-	117	-	117
Total ECL alternative weights	**700**	**117**	**355**	**56**	**78**	**1,306**	**66**	**1,372**
Change in ECL if alternative weights were used	**142**	**28**	**49**	**18**	**24**	**261**	**8**	**269**

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 70 per cent of the ECL in the expected scenario. The downside scenario gives more than double the ECL than in the expected scenario. Applied scenario weighting gives about 26 percent higher ECL than in the expected scenario.