SpareBank 1 SMN

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 various pension schemes, 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.

The Group has obtained a new calculation of pensions as of 30 September 2022:

Actuarial assumptions	**31 Dec 2021**	**1 Jan 2021**	**30 Sep 2022**
Discount rate	1.6 %	1.5 %	3.2 %
Expected rate of return on plan assets	1.6 %	1.5 %	3.2 %
Expected future wage and salary growth	2.3 %	2.0 %	3.5 %
Expected adjustment on basic amount (G)	2.3 %	2.0 %	3.5 %
Expected increase in current pension	0.0 %	0.0 %	0.0 %
Employers contribution	19.1 %	19.1 %	19.1 %

Demographic assumptions:	
Mortality base table	K2013BE
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.January 2022	-62	8	-54
OCI accounting Opening balance	0	0	0
OCI accounting Closing balance	-170	-1	-171
Net defined-benefit costs in profit and loss account	-1	0	-1
Paid in pension premium, defined-benefit schemes	0	0	0
Paid in pension premium, defined-benefit plan	0	-1	-1
Net pension liability in the balance sheet 30 September 2022	**-233**	**7**	**-226**

Net pension liability in the balance sheet Group (NOKm)	30 Sep 2022	31 Dec 2021
Net present value of pension liabilities in funded schemes	520	645
Estimated value of pension assets	-748	-701
Net pension liability in the balance sheet before employer's contribution	-227	-56
Employers contribution	1	1
Net pension liability in the balance sheet	**-226**	**-54**

Pension cost Group (NOKm)	30 Sep 2022	31 Dec 2021
Present value of pension accumulated in the year	0	0
Net interest income	-1	-2
Net pension cost related to defined plans, incl unfunded pension commitment	-1	-1
Empolyer's contribution subject to accrual accounting	0	0
Cost of defined contribution pension and early retirement pension scheme	90	115
Total pension cost for the period	**89**	**113**

Investment held for sale

SpareBank 1 SMN's strategy is that ownership due 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.

Jan-Sep 2022 (NOKm)	Assets	Liabilities	Revenue	Expenses	Profit	Ownership
Mavi XV AS Group	111	2	9	-9	0	100 %
Total Held for sale	**111**	**2**	**9**	**-9**	**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 2021.

The input in the credit loss model have been changed in 2020 and 2021 a result of increased uncertainty due to the corona situation. This uncertainty has been significantly reduced, but in 2022 macroeconomic uncertainty has increased as a result of the war in Ukraine, a strong increase in energy and raw material prices, challenges in the supply chains and the prospect of permanently higher inflation and interest rates made the assessments extra demanding. The bank has focused on the expected long-term effects of the crisis.

In 2020, the bank changed the assumptions for the base scenario in a negative direction. These assumptions were continued in 2021. The bank's exposure to hotels and tourism, including commercial real estate with the income mainly towards this industry, was 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 losses in the individual scenarios are projections of trajectories for the probability of default (PD) and losses in case of default (LGD). In addition, the expected loss is affected by the probability weight for the individual scenario. The expected negative effects of the corona pandemic were in the assessments for 2020/2021 primarily linked to debtors who had a demanding starting point before the crisis – typically debtors in stage 2. The bank therefore chose to increase the trajectories for PD and LGD, as well as reduce expected repayments in the base scenario, especially from year two onwards. This change affects the expected loss for debtors in stage 2. To adjust for migration into stage 2, the PD and LGD estimates were also increased in the first year. No first year repayments are assumed for all portfolios in the downside scenario. The effects of the corona pandemic was significantly smaller than expected. This is due, among other things, to implemented authority measures. The bank therefore decided to reverse the pandemic-related mark-ups in the trajectories in the base scenario in the third quarter of 2021 for PM and in the first quarter of 2022 for BM. In second and third quarter 2022, upward adjustments have been made to the PD and LGD trajectories throughout the assessment period against the backdrop of a rising interest rate market which, in combination with the inflation, leads to an expectation of an increased level of default and lower asset values in the future

The applied scenario weighting was changed in 2020 to reflect further increased uncertainty. For corporate market including offshore, as well as agriculture, the downside scenario was changed from a weighting with a 10 percent probability, to a weighting of a 20 percent probability. For retail market, the weighting of the downside scenario was changed from 10 to 15 per cent. In 2022, the weighting of the downside scenario was increased to 25 per cent in the agriculture and other business portfolios (excluding offshore) and hotels/tourism to take into account increased uncertainty as a result of the war in Ukraine as well as generally greater uncertainty with regard to future economical growth. In the third quarter of 2022, the weighting of the downside scenario has also been increased in the subsidiary SpareBank1 Finans Midt-Norge from respectively 10 to 25 per cent for BM and from 10 to 15 per cent for PM.

The effect of changes in input assumptions is shown as "Effect of changed assumptions in ECL model" in note 7.

The write-downs are reduced as a result of the removal of mark-ups in the base scenario for the business portfolio (excl. offshore and hotels) and reduced markup in PD and LGD projectories for hotel/tourism (down from a very high level). On the other hand, write-downs are increasing both for business and industry the personal market portfolio as a result of a new mark-up in PD and LGD trajectories as a result of a significantly increased interest rate level. In addition, increased weight on low scenario for the business portfolio result in increased write-downs. In total, this amounts to NOK 82 million for the bank and NOK 98 million for the group in reduced write-downs

Sensitivity

The first part of the table below show total calculated expected credit loss as of 30 September 2022 in each of the three scenarios, distributed in the portfolios Retail Market, Corporate Market (excl offshore and agriculture) and offshore, tourism and agriculture, which adds up to parent bank. In addition the subsidiary SpareBank 1 Finans Midt-Norge is included with portfolios Corporate and Retail Market. 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 scenario weight has been doubled.

If the downside scenario's probability were doubled at the expense of the baseline scenario at the end of September 2022, this would have entailed an increase in loss provisions of NOK 259 million for the parent bank and NOK 280 million for the group.

	CM	RM	Offshore	Tourism	Agriculture	Total parent	SB 1 Finans MN, CM	SB 1 Finans MN, RM	Group
ECL base case	465	71	314	15	41	905	36	20	962
ECL worst case	1,069	236	512	74	148	2,038	82	70	2,190
ECL best case	361	28	218	7	22	635	24	13	672
ECL with scenario weights used 60/25/15	601	-		-	65	665	44	-	709
ECL with scenario weights used 65/20/15	-	-	339		-	339	-	-	339
ECL with scenario weights used 60/30/10			-	32		32		-	32
ECL with scenario weights used 70/15/15	-	89	-	-	-	89	-	26	115
Total ECL used	**601**	**89**	**339**	**32**	**65**	**1,126**	**44**	**26**	**1,196**
ECL alternative scenario weights 35/50/15	752	-	-	-	91	843	57	-	900
ECL alternative scenario weights 45/40/15	-	-	379	-	-	379	-	-	379
ECL alternative scenario weights 30/60/10	-	-	-	49	-	49	-	-	49
ECL alternative scenario weights 55/30/15		114		-		114		33	147
Total ECL alternative weights	**752**	**-**	**379**	**49**	**91**	**1,385**	**57**	**33**	**1,476**
Change in ECL if alternative weights were used	**151**	**25**	**40**	**18**	**27**	**259**	**14**	**7**	**280**

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 over double the ECL than in the expected scenario. Applied scenario weighting gives about 25 percent higher ECL than in the expected scenario.