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

Sparebank 1 SMN Group has one pension arrangement; defined contribution plan. For a further description of the pension scheme, see note 22 in the 2022 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 2023.

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.

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From fourth quarter 2022, the subsidiary SpareBank 1 Markets is classified as held for sale. On 22 June 2022, SpareBan 1 SMN announced that SpareBank 1 Markets is strengthening its investment within the capital market and SpareBank 1 SR-Bank and SpareBank 1 Nord-Norge will be its majority owners. SpareBank 1 SR-Bank and SpareBank 1 Nord-Norge will transfer their markets business to SpareBank 1 Markets, and also buy into the company in the form of a cash consideration. After completion of the transaction, SpareBank 1 SMN will own 39.4 per cent and SpareBank 1 Markets will be treated as an associated company. The transaction is dependent on approval from the Norwegian Financial Supervisory Authority and the Norwegian Competition Authority, and is planned to be completed in second half of 2023.

Profit from SpareBank 1 Markets has been reclassified as shown:

Income Statement (NOKm)	Second quarter 2023	Second quarter 2022	First half 2023	First half 2022
Net interest	-6	2	-14	4
Commission income and other income	-164	-189	-322	-304
Net return on financial investments	-36	-87	-78	-148
Total income	**-206**	**-276**	**-414**	**-448**
Total operating expenses	-164	-173	-328	-306
Result before losses	**-41**	**-101**	**-86**	**-142**
Loss on loans, guarantees etc.	-	-	-	-
Result before tax	**-41**	**-101**	**-86**	**-142**
Tax charge	6	15	13	18
Net profit for investment held for sale	**37**	**87**	**74**	**-124**

January - June 2023 (NOK Million)	Assets	Liabilities	Revenue	Expenses	Profit	Ownership
Mavi XV AS Group	80	26	8	7	1	100 %
SpareBank 1 Markets	2,404	1,577	414	341	74	67 %
Total Held for sale	**2,484**	**1,604**	**422**	**349**	**74**	

Losses on loans and guarantees

For a detailed description of the Bank's model for expected credit losses, refer to note 10 in the annual accounts for 2022.

In the second quarter of 2023, an upgraded loss model was used for the first time, which provides proposals for key assumptions when using regression analysis and simulation. Future default level (PD) is predicted based on the expected development in money market interest rates and unemployment. Future level of loss (LGD) is simulated based on collateral values and expectations of price development for collateral objects i various industries. With SpareBank 1 SMN's assumptions in the new model, write-downs are to a greater extent than previously allocated to industries with large interest-bearing debt such as property, shipping and fisheries. Norges Bank's Monetary Policy Report has been chosen as the main source for the explanatory variables interest rate and unemployment as well as the expected price development of residential property. Management's estimates and discretionary assessments of the expected development of default and loss levels (PD and LGD) were largely based on macro forecasts from Monetary Policy report (PPR) 2/23. In PPR 2/23, rising unemployment and increased interest rates are expected. The bank assessed as of 30 June 2023 that the changes in the macro forecasts, compared to the equivalent as of 31 March 2023, overall called for marginally higher default levels and approximately equal degree of loss in case of default. The scenario weighting is subject to ongoing assessment based on available information. In 2022, the probability of a low scenario for corporate market excl. offshore increased for several reasons - increased macroeconomic uncertainty as a result of the war in Ukraine, strong increases in energy and raw material prices, challenges in supply chains and prospects for permanently higher inflation and interest rates. Future loss expectations were increased both in 2022 and in the first quarter of 2023 in that PD and LGD pave the way for both the personal market and the corporate market excl. offshore was raised in the base scenario. The bank has focused on the expected long-term effects of a higher interest rate and weaker economic growth. For offshore portfolio, in the course of 2022, as a result of a significant improvement in the market and market prospects, increased earnings assumptions in the simulations and weight for the low scenario were reduced for supply and subsea. From the first quarter of 2023 is the model write-downs for the offshore portfolio calculated with the same assumptions as for the corporate market in general. Expected credit loss (ECL) per 30 june 2023 was calculated as a combination of 75 per cent expected scenario, 15 per cent downside scenario and 10 percent upside scenario (75/15/10 percent) for the business market including agriculture, and 70 percent expected scenario, 15 percent downside scenario and 15 per cent upside scenario (70/15/15 per cent) for the retail market.

The effect of the revision of assumptions in 2023 is shown in the line “Changes due to changed input assumptions in the credit loss model” in note 8. Write-downs are increasing for both the corporate and retail market portfolios as a result of significantly increased interest rates and inflation expected to increase future levels for PD and LGD. In total, this amounts to NOK 60 million for the bank and NOK 48 million for the group in increased write-downs.

Sensitivity

The first part of the table below show total calculated expected credit loss as of 30 June 2023 in each of the three scenarios, distributed in the portfolios Retail Market, Corporate Market 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 2023, this would have entailed an increase in loss provisions of NOK 192 million for the parent bank and NOK 214 million for the group.

	CM	RM	Agriculture	**Total parent**	SB 1 Finans MN, CM	SB 1 Finans MN, RM	**Total group**
ECL base case	752	101	48	**901**	37	24	**963**
ECL worst case	16,744	293	212	**2,179**	94	85	**2,359**
ECL best case	524	43	25	**592**	22	15	**629**
ECL with scenario weights used 75/15/10	867	-	71	**938**	-	-	**987**
ECL with scenario weights used 60/25/15	-	-	-	**-**	49	-	**49**
ECL with scenario weights used 70/15/15	-	121	-	**121**	-	32	**153**
Total ECL used	**867**	**121**	**71**	**1,059**	**49**	**32**	**1,190**
ECL alternative scenario weights 60/30/10	1,006	-	95	**1,101**	-	-	**1,101**
ECL alternative scenario weights 35/50/15	-	-	-	**-**	64	-	**64**
ECL alternative scenario weights 55/30/15	-	150	-	**150**	-	40	**190**
Total ECL alternative weights	**1,006**	**150**	**95**	**1,251**	**64**	**40**	**1,355**
Change in ECL if alternative weights were used	**138**	**29**	**25**	**192**	**14**	**8**	**214**

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 24 percent higher ECL than in the expected scenario.