Major Q&A at SMBC Group IR Day 2022

1. Wholesale Business Unit
Masahiko Oshima, Deputy President and Executive Officer
Muneo Kanamaru, Senior Managing Executive Officer

Q1. What are the initiatives to improve loan spreads?

A1. It is not easy to improve loan spreads in Japan, where negative interest rate policy is still maintained. However, we continue negotiations with clients to secure appropriate risk returns, as well as improving overall spread by actively allocating assets to loans with higher spreads (e.g. equity finance, revitalization finance, LBO finance, and real estate finance.)

Q2. How much demand for sustainable finance and its profit contribution are expected ?

A2. We have executed JPY 2.4 trillion of sustainable finance in the past two years. I expect the demand to further increase as our clients focus on decarbonizing their operations. However, higher demand will not necessarily increase our profit. Clients are required to take measures towards 2030 and 2050 even though they have no clear solution. We are building close relationships with them, by having discussions on their underlying management needs and supporting them to find solutions. As a result, new business opportunities are emerging. I am confident that we are going in the right direction, but we may have to wait a little to see profit contribution.

Q3. Is there room to accelerate the pace of reducing strategic shareholdings?

A3. We first aim to complete our current JPY 300 billion reduction plan and if possible, accelerate the reduction speed to exceed the target. We conduct engagements to gain clients’ understanding before selling their shares. As the Corporate Governance Code penetrated gradually within Japanese corporations, we will continue to gain consent from clients and make progress.

2. **Retail Business Unit**
Takashi Yamashita, Senior Managing Executive Officer

Q1. What is the future direction of retail branch reorganization?

A1. We have been working on retail branch reorganization since the previous Medium-Term Management Plan, and we aim to further reduce staffs and improve productivity by digitalizing services and promoting straight through processing. At the same time, we will develop an efficient branch network and enhance customer convenience by consolidating branches on a group basis as well as establishing new branches in places where many visitors could be expected. We will pursue further cost reduction through these initiatives in the next Medium-Term Management Plan to secure necessary expenses for IT investments, advertising, etc.

Q2. What is the objective of the capital and business alliance with SBI Group?

A2. We entered a capital and business alliance with SBI Group to collaborate in digital financial services for individuals, after making good achievements in securities, credit card, and online security trading businesses since we started business alliance in 2020. Going forward, we are planning to connect various financial services of SMBC Group and SBI SECURITIES on one digital platform by leveraging client base of both companies. I believe this platform will increase cross-selling dramatically beyond the boundaries of the two groups and expand our customer base. On the other hand, SMBC Nikko Securities will continue to be the core securities company of SMBC Group. We will promote retail businesses by leveraging each company’s strength: face-to-face services for SMBC Nikko Securities and digital services for SBI SECURITIES.

Q3. How will you grow the credit card business?

A3. It is necessary to increase the number of customers and transaction volume in the Japanese cashless payment market, where commission rates are on a downward trend. We provide payment terminals called “stera terminal” in order to expand transaction with merchants and the number of terminals installed has been steadily increasing, including at large merchants’ branches. We are also providing “Custella,” one of the most major cashless data analysis services in the industry.

Q4. Why did the downward trend in card loan balance reverse?

A4. The balance of card loans decreased significantly due to sluggish individual consumption under the COVID-19 pandemic. Now that the domestic economy and individual consumption recovered due to the easing of restrictions, loan demand is coming back. In addition, by leveraging data marketing and improving the usability of apps, we are increasing our market share and the loan balance is currently growing at a higher pace than before COVID.

3. Global Business Unit
Tetsuro Imaeda, Senior Managing Executive Officer
Akihiro Fukutome, Senior Managing Executive Officer

Q1. What is the business plan of the digital retail banking in the United States?

A1. We judged that this was the best timing to enter because 1) the market is promising in all aspects including size, growth potential, and profitability, 2) this business will contribute to diversify our business portfolio as correlation with the existing businesses is low, and 3) it can be launched shortly with little investment. Our strength is that we can run the service on the cloud. It is possible for us because we are entering the market at this timing; not many players can operate the same way even in the U.S. Another advantage is that we can develop products that meet customer needs on our own shortly. I expect tens of billions of yen contribution to our bottom-line profit and more than 10% ROE in the next 10 years.

Q2. Will additional losses be booked regarding exposures to Russia?

A2. We have booked JPY 47 billion of impairment in FY3/2022 to aircraft leased to Russian airlines. Impairment rate was calculated by drawing numerous scenarios toward repossession and we will consider additional impairment depending on future circumstances. On the other hand, we booked JPY 75 billion of credit cost in FY3/2022 including forward-looking provisions. Majority of our Russian borrowers have no problem with their business performance and are making principal and interest payments as scheduled. We do not think additional provisions are necessary at this point but may book some depending on future circumstances.

Q3. What is the outlook for credit cost amid rising U.S. interest rates and concerns for recession?

A3. We have controlled our credit cost within the planned level even under the COVID-19 pandemic and the Russia-Ukraine situation. Although there are currently no major concerns other than the Russian situation, we are paying attention to the recent deterioration in the economic environment and rising geopolitical risks and may consider a cautious approach in taking credit risks if necessary.

Q4. What are the growth drivers for overseas CIB business in the next Medium-Term Management Plan?

A4. We will continue to strengthen the overseas securities business by organizing structure and expanding products over the medium- to long-term, though it is currently facing headwinds. In the U.S., we are filling the gap between our ambition and capability: allocating more human resources, developing infrastructures for sectors that we have not invested a lot in the past, and deepening collaboration with Jefferies. We are also working to expand our CIB business globally from the U.S. to Europe and Asia.

4. Global Markets Business Unit
Masamichi Koike, Senior Managing Executive Officer

Q1. Do you think that the Bank of Japan (BOJ) will change its monetary policy?

A1. I believe Japan will not be the only country to escape the inflation that is now occurring in the world. We have entered the “New Cold War” era where many countries are strengthening nationalism as deglobalization proceeds and the inflation is caused by this environment in addition to supply factors due to the COVID-19 pandemic, decarbonization, etc. I think BOJ could change its monetary policy in the future, considering this circumstance. It is very difficult to tell when due to the uncertainty of future inflation, but they could take action when their governor changes next April.

Q2. What is the outlook for U.S. dollar interest rates in the future?

A2. The Fed may be forced to change its monetary policy if there would be deep recession in the U.S., but I think the timing should be from January to June of 2023 at the earliest. Inflation is not yet at a stabilizing stage considering the fundamentals of the U.S. economy. I expect that the tight monetary policy of the Fed would continue and that the risk of rising interest rates would remain high until the end this year.

Q3. What is the investment policy for foreign bonds?

A3. It would be too partial to talk only about foreign bonds as we manage our portfolio as a whole, because the portfolio of Global Market Business Unit consists of foreign bonds, JGB, foreign stocks, Japanese stocks, and other investment products as well as loans and deposits of both foreign currency and Japanese yen. We have used hedge positions to minimize our risk volume of foreign bonds under the rising interest rates. I would like to capture the market trend reversal that could happen next year such as the U.S. falling into recession, inflation stabilizing, and the Fed changing its monetary policy.

Q4. Do you intend to diversify your assets such as alternatives and commodities?

A4. We have been investing in various assets while the market was supported by excess liquidity, but now, we should change the way. For example, we should consider economic security when selecting which product to invest in under this paradigm shift like the “New Cold War”. We will continue to flexibly change our portfolio as “there is no royal road in the world of investment.”

5. **CFO session**
Toru Nakashima, Senior Managing Executive Officer

Q1. How will you balance growth investments and shareholder returns?

A1. Our FY3/2023 bottom-line forecast of JPY 730 billion can be allocated as excess capital to growth investments and shareholder returns since our current CET1 ratio fulfills the target of around 10%. JPY 300 billion out of this is for dividend and some amount will be allocated to organic growth including replacement of assets and increase of asset value due to Japanese yen depreciation. The remaining capital can be allocated to inorganic growth investments and share buybacks. We do not expect execution of growth investments this year to be as large as FY3/2022, but we would like to consider if there are good opportunities in strategic business areas. Even in that case, we still have enough capital to execute share buyback as long as we can achieve our bottom-line target.

Q2. What conditions are required to achieve ROCET1 of 10% or more in the medium- to long-term?

A2. I think ROCET1 in the next Medium-Term Management Plan should at least exceed the current target of 8.5%. In order to aim for 10% or more, improvement of the external environment, such as rise in Japanese yen interest rates, is essential. Nevertheless, this is a level that must be targeted in the long-term, and we will discuss what measures we should implement to achieve this level and when it can be achieved, possibly after the next Medium-Term Management Plan.

Q3. When do you expect to start repurchasing shares for the buyback program announced in November 2021 and establish a new program for FY3/2023?

A3. It is taking longer than initially expected to start the share buyback. Even if we could start in September, I think it would be almost impossible to complete the JPY 100 billion buyback program by its deadline on November 11 because it took around 3 months to repurchase the same amount of shares in 2019. In addition, we should not start the share buyback in or after October to avoid any buyback while there are undisclosed information relating to the 1H FY3/2023 financial results. Therefore, the most likely scenario is that we end the existing program without repurchasing any shares and renew it at the same amount when announcing our 1H FY3/2023 financial results.

As to the buyback for FY3/2023, we did not announce in May due to the very uncertain situation in Russia and outlook of the global economy. However, we will continue discussions at our Board of Directors in light of future conditions, progress of bottom-line profit and other factors. The decision will be made independently from the status of the existing buyback program.