

Risk Management

Our Approach

Strengthening of compliance and risk management is positioned as a key issue in SMBC Group's Principles of Action on Compliance and Risk. SMBC Group is therefore devoted to improving its systems in these areas in order to become a truly outstanding global group.

Risk Culture

In order for SMBC Group to realize and maintain a sustainable growth in corporate value as a "Top Tier Global Financial Group," each one of our colleagues should think and judge on their own if their actions meet the expectations and requirements of customers, markets, and other stakeholders, not just if they are compliant with laws and regulations. SMBC Group has established "Principles of Action on Compliance and Risk" for every colleague to hold onto as a "keystone" of their daily business. The principles include "Business based on the Risk Appetite Framework" and "We will conduct business operations with risk ownership of the risks, such as credit risk, market risk, liquidity risk, operational risk, and conduct risk, that arise in our own business." Concrete measures include internal surveys for monitoring the compliance awareness and risk sensitivity of our colleagues as well as internal training for fostering a sound risk culture.

Risk Appetite Framework

SMBC Group has introduced a Risk Appetite Framework for controlling group-wide risks that clarifies the types and levels of risk that we are willing to take on or are prepared to tolerate in order to grow profits (risk appetite). The Risk Appetite Framework is one of two pivots of our business management alongside business strategies. It functions as a management framework for sharing information on the operating environment and risks facing SMBC Group among management and for facilitating appropriate risk taking based thereon.

Risk Appetite Framework Positioning



Risk Appetite Composition

Categories			
Soundness	Profitability	Liquidity	Credit
Market	Climate-related	Operational	Conduct**1
Established for each category			
Risk Appetite Statement		Risk Appetite Measures	
A qualitative explanation of our approach to risk taking and risk management for various risk categories		Quantitative Risk Appetite Measures that function as benchmarks for risks that we are considering taking and for risk/return	

*1 Conduct risk is the risk that our conduct negatively affects customers, market integrity, effective competition, public interest, and SMBC Group's stakeholders, through acts that violate laws and regulations or social norms.

Individual risk appetites have been established by strategies for each business unit as necessary based on the overall risk appetite of SMBC Group. Risk appetites are decided during the process of formulating business strategies and management policies. These risk appetites are set based on Top Risks that threaten to significantly impact management and on risk analyses (stress testing) that illustrate the impact if a risk should materialize.

In addition, risk register and Key Risk Events (KRE) are utilized as part of a system for assessing the risks present in new and existing business activities and for verifying the adequacy of Top Risks, risk appetites, and business strategies.

The outlooks for the operating environment and risks and the risk appetite situation are monitored throughout the course of the fiscal year. Risk Appetite Measures and business strategies are revised as necessary. For example, overall risk capital*2 has been selected as an indicator for risk appetite, which displays the soundness of SMBC Group. Overall risk capital is the aggregate of the risk capital amounts for each risk category. Management standards have been set for the upper limit for overall risk

capital based on group-wide management constitution. Overall risk capital levels are thus monitored throughout the course of each fiscal year to clearly indicate risk-taking capacity and promote the sound taking of risks.

In addition, specific risk appetite indicators have been set for credit risk, market risk, liquidity risk, and other risk categories to facilitate appropriate management based on a quantitative understanding of risk appetite.

*2 The amount of capital required to cover the theoretical maximum potential loss arising from risks of business operations.

Top Risks

SMBC Group identifies risks that threaten to significantly impact management as Top Risks.

The selection of Top Risks involves comprehensive screening of risk factors, evaluation of each risk scenario's possibility of occurrence and potential impact on management, and discussion by the Risk Management Committee and the Management Committee. Top Risks are utilized to enhance risk management by being incorporated into discussions of the Risk Appetite Framework and the formulation of business strategies and into the creation of risk scenarios for stress testing.

World economic stagnation	Disasters such as large-scale earthquakes, storms, and floods
Highly volatile commodity price and financial / foreign exchange markets	Lack of preparedness against cyber attacks and financial crimes
Sudden deterioration of the foreign currency funding conditions	Changes in industrial structure due to technological innovation
Japanese economic stagnation	Inadequate responses to climate change risk and environmental issues
Japanese fiscal instability	Inadequate responses to human rights issues
The U.S. - China struggle for supremacy	Improper labor management
Growing tensions around Russia-Ukraine conflict	Misconduct such as an employee's inappropriate behavior
Unstable situations in the Middle East and Asia	Inadequate improvement in the operational resilience system
Political turmoil and social instability	Inadequate preparedness for heightened regulatory and supervisory scrutiny
Outbreak of serious infectious disease	Difficulty in securing human resources

Note: The above is only a portion of the risks recognized by SMBC Group. It is possible that the materialization of risks other than those listed above could have a significant impact on our management.



See page 151 for Top Risks.

Risk Management

■ Stress Testing

At SMBC Group, we use stress testing to analyze and comprehend the impact on SMBC Group's businesses of changes in economic or market conditions, in order to plan and execute forward-looking business strategies.

In our stress testing, we prepare multiple risk scenarios including macroeconomic variables such as GDP, stock prices, interest rates, and foreign exchange rates based on the aforementioned Top Risks, discussions with experts and related departments.

When developing business strategies, we set out scenarios assuming stressed business environments such as serious economic recessions and market disruption for the sake of assessing risk-taking capabilities at SMBC Group and verifying whether adequate soundness can be maintained under stress. For example, we are conducting stress testing assuming prolonged monetary tightening in the U.S. and Europe, a global credit crunch, and economic stagnation in Japan to verify the soundness of SMBC Group's capital and confirm the appropriate actions to be taken.

During a fiscal year, we will conduct stress testing in a timely manner to assess the potential impact on our business and to take the appropriate actions in case a serious risk event occurs.

In addition, we conduct detailed stress testing for individual risks such as credit risk, market risk, and liquidity risk, so as to decide and review risk-taking strategies.

We are also conducting scenario analyses on physical and transition risks related to climate change.



See page 085 for more information on our climate change risk analysis.

■ Risk Register

A risk register is formulated by each business unit for the purpose of realizing more sophisticated risk governance and enhancing business units' risk ownership. In formulating these registers, business units communicate with risk management departments to identify the risks present in their business, and these risks are reflected in business strategies after they have been evaluated and the adequacy of measures for controlling them has been verified.

■ Key Risk Events

Key Risk Events (KRE), external events that indicate the increased threat of risks, have been identified to ascertain the symptoms of the potential risks. KRE are utilized to analyze and assess how likely similar cases will occur in SMBC Group and what effects such similar cases will have on SMBC Group, and to enhance our risk management system.

■ Operational Resilience

In recent years, the risk environment surrounding financial institutions has been rapidly changing, with the emergence of pandemics and increasingly sophisticated cyberattacks, as well as reliance on IT systems and the spread of cloud service use.

In response to this environment, in addition to our existing risk management framework, we recognize that one of our important responsibilities is to strengthen our ability to continue and promptly restore critical operations (operational resilience) on the assumption that business interruption may occur, and we are working on the following measures.

Efforts are made to ensure effectiveness by reviewing the following cycles according to the operational and internal/external environment.

1. Identify critical operations that could pose a significant risk in the event of a disruption in service delivery
2. Set the tolerable time for interruption to critical operations in consideration of alternative means, etc.
3. Identify management resources essential to the provision of critical operations and organize their interdependencies
4. Conduct scenario testing to verify appropriateness of resource allocation, and review periodically.

Risk Management Systems

Based on the recognition of the importance of risk management, top management is actively involved in the risk management process, and systems are in place for verifying and monitoring the effectiveness and appropriateness of this process. Specifically, the groupwide basic policies for risk management and the Risk Appetites for the entire SMBC Group are determined by the Management Committee and authorized by the Board of Directors. After that, the status of risk management based on these policies and risk appetites is reported to the Board of Directors by the Group CRO four times per year.

If the outlooks for the operating environment and risks change drastically from the assumption in the beginning of the fiscal year, we will review the Risk Appetite for the entire group in a timely and appropriate manner with approval by the Board of Directors.

We have also clarified related roles and responsibilities of relevant divisions in light of our three lines of defense. With these provisions in place, risk management systems have been established based on the characteristics of particular businesses, and measures are being put in place to strengthen and improve the effectiveness of these systems in accordance with these basic policies for risk management.

Furthermore, SMBC Group is strengthening groupwide risk management systems through the Group CRO Committee and the Global CRO Committee.

Three Lines of Defense

The Basel Committee on Banking Supervision's "Corporate governance principles for banks" recommends "three lines of defense" as a framework for risk management and governance. Based on this framework, we have clarified the roles and responsibilities of each unit, as shown in the table on the right, and we are taking steps to achieve more effective and stronger risk management and compliance frameworks.

SMBC Group's Risk Management System



Principal Organizations	Roles and Responsibilities
First Line Business Units	<p>The Business Units shall be risk owners concerning their operations and shall be responsible for the following in accordance with the basic principles provided by Second Line.</p> <ul style="list-style-type: none"> • Identification and evaluation of risks encountered in the business activities • Implementation of measures for minimizing and controlling risks • Monitoring of risks and reporting within First Line and to Second Line • Creation and fostering of a sound risk culture
Second Line Risk Management and Compliance Departments	<p>The Risk Management and Compliance Departments shall assume the following functions and responsibilities in order to manage the risk management and compliance systems.</p> <ul style="list-style-type: none"> • Drafting and development of basic principles and frameworks concerning risk management and compliance • Oversight, monitoring, and development of training programs for First Line
Third Line Audit Department	<p>Independent from First Line and Second Line, the Audit Department shall assess and verify the effectiveness and appropriateness of risk management and compliance systems managed and operated by First Line and Second Line, and report these results to the Audit Committee and the Management Committee. The Department shall provide recommendations regarding identified issues / problems.</p>

Column

Risk Management Initiatives Amid a Volatile Financial and Economic Environment

In FY 2022, interest rates in various countries rose as monetary policy authorities in the U.S., Europe, and other countries tightened monetary policy due to sharply rising inflation and other factors.

We identified "highly volatile financial / foreign exchange markets" and "sudden deterioration of foreign currency funding conditions" as our top risks, and conducted stress testing. We discussed this at the Management Committee and the Risk Committee to determine the action for better addressing market deterioration.

In the face of the market turmoil triggered by the bankruptcy of Silicon Valley Bank and the subsequent bank failures in March 2023, we analyzed our risk profile, including testing the survival period in terms of liquidity risk under the stress, and decided policy quickly, while closely communicating and coordinating with the relevant departments.

We also recognize these incidents as Key Risk Events (KRE) and analyze our deposit and securities portfolios. Through these efforts, we will continue to further enhance our risk management.