



Risk Management

Risk Management Categories

SMBC Group defines the following risk management categories and conducts management of these risks accordingly. Group companies manage risk in accordance with the characteristics of their particular businesses. These risk categories are continuously reviewed and new ones may be added in response to changes in the operating environment.

| Risk Category | | Department in Charge |
|-------------------------------|--|--|
| Credit risk | Credit risk is the possibility of a loss arising from a credit event, such as deterioration in the financial condition of a borrower, that causes an asset (including off-balance sheet transactions) to lose value or become worthless. | Credit & Investment Planning Department |
| Market risk | Market risk is the possibility that fluctuations in interest rates, foreign exchange rates, equity prices, or other market prices will change the market value of financial products, leading to a loss. | Corporate Risk Management Department Risk Management Information Department |
| Liquidity risk | Liquidity risk is defined as uncertainty around the ability of the firm to meet debt obligations without incurring unacceptably large losses. Examples of such risk include the possible inability to meet current and future cash flow / collateral needs, both expected and unexpected. In such cases, the firm may be required to raise funds at less-than-favorable rates or be unable to raise sufficient funds for settlement. | Corporate Risk Management Department Risk Management Information Department |
| Operational risk | Operational risk is the possibility of losses arising from inadequate or failed internal processes, people, and systems or from external events (see page 138 for information on risk categories and the departments in charge). | Corporate Risk Management Department Risk Management Information Department |
| Conduct risk | Conduct risk is the risk that our conduct negatively affects customers, market integrity, effective competition, public interest, and the SMBC Group's stakeholders through acts that violate laws and regulations or social norms. | Corporate Risk Management Department Compliance Department |
| Model risk | Model risk is the risk of potential adverse consequences or financial loss resulting from misinformed decision making based on inaccurate model outputs or using the model inappropriately. | Corporate Risk Management Department |
| Reputational risk | Reputational risk refers to the risk of not meeting the expectations for high ethics, integrity, etc. by the stakeholders (that is, customers, shareholders, market, society, environment, employees, etc.) due to the business of the SMBC Group and the behavior of employees and other related parties, as well as of leading to impairment of the Enterprise Value and decline in trust. | General Affairs Department Public Relations Department |
| Environmental and social risk | Environmental and social risks are the risks that environmental and social factors become risk drivers and transmit through various pathways to each risk category, ultimately resulting in losses to the SMBC Group. | Environmental & Social Risk Management Department of Credit & Investment Planning Department Sustainability Planning Department |

Top Risks

Top Risks, risks that threaten to significantly impact management, recognized by SMBC Group are listed in the table below.

| Top Risks | Example Scenarios |
|---|---|
| Political turmoil and social instability | · Deterioration of the business environment due to radical policies in areas such as trade, diplomacy, and finance |
| Intensification of U.S.-China struggle for supremacy | · Deterioration of the business environment due to political conflict between the U.S. and China, and growing concerns over the security environment |
| Growing tensions over Russia-Ukraine conflict | · Escalation of confrontation between Russia and NATO over ceasefire negotiations |
| Unstable situations in Asia and the Middle East | · Occurrence of emergency incidents on the Korean Peninsula, and sudden surge in resource prices due to worsening situation in the Middle East |
| Increasing threats in cyberspace | · Business suspension or information leakage due to cyberattacks targeting SMBC Group or third parties |
| World economic stagnation | · Shift back to monetary tightening in the western countries due to a resurgence of inflation |
| Highly volatile markets, sudden deterioration of Non-JPY funding condition | · Rapid position adjustments following central banks' policy changes |
| Manifestation of a global financial crisis | · Emergence of a global financial crisis due to the failures of banks and rapid outflow of funds from shadow banks |
| Japanese economic stagnation | · Economic recession due to rapid yen appreciation and worsening external demand |
| Japanese fiscal instability | · Increased concerns over government debt due to rising fiscal expansion pressures |
| Outbreak of serious infectious disease | · Occurrence of a pandemic due to the emergence of a virus or bacterium that is highly infectious to humans |
| Increase in disasters such as large-scale earthquakes, storms, and floods | · Negative impact caused by the occurrence of large-scale earthquakes and volcanic eruptions, the increased frequency of extreme weather events and natural disasters |
| Delayed response to industry structural changes caused by technological innovation | · Decline in competitiveness due to rapid digitalization of financial services |
| Sophistication of disinformation and unexpected rapid spread of information | · Delayed response to unexpected spread of information via Social Networking Services |
| Divide in policy, regulation and social norm on environment and human rights issues | · Reputational damage and emergence of stranded assets due to diverse views on environmental and human rights issues and inadequate response to climate change |
| Misconduct damaging customer protection and market integrity | · Administrative actions and deterioration of our company's reputation due to employees' inappropriate behavior and serious disciplinary violations |
| Inadequate preparedness for AML/CFT | · Administrative actions and deterioration of our company's reputation due to inadequate preparedness for AML/CFT/CPF controls |
| Inadequate responses to system failures | · Significantly negative impact on customers and deterioration of our reputation due to system failures of our company and third parties |
| Inadequate preparedness for heightened regulatory and supervisory scrutiny | · Impact on our business due to the strengthening of financial supervision and regulation |
| Difficulty in securing human resources | · Shortage of personnel and specialists appropriate for business strategy and management foundation, and decline in medium- to long-term competitiveness |

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.

Stress Testing

SMBC Group conducts stress testing for each category of risks as well as stress testing used to verify the overall soundness of comprehensive risk management practices. The level of soundness used for verification here is determined from the perspective of risk appetite, based on the intensity of the assumed scenario.

When evaluating group-wide soundness, evaluations are made using consolidated balance sheets and consolidated statements of income, which include data from affiliates, with the goal of identifying major risks to our business and asset portfolio. Specifically, scenarios are selected based on the aforementioned severity level as well as background conditions that cover all areas in which we may face risks (e.g. an outlook encompassing the entire world). We also employ methodology for ensuring scenarios can be accurately reflected and for incorporating business and portfolio characteristics.

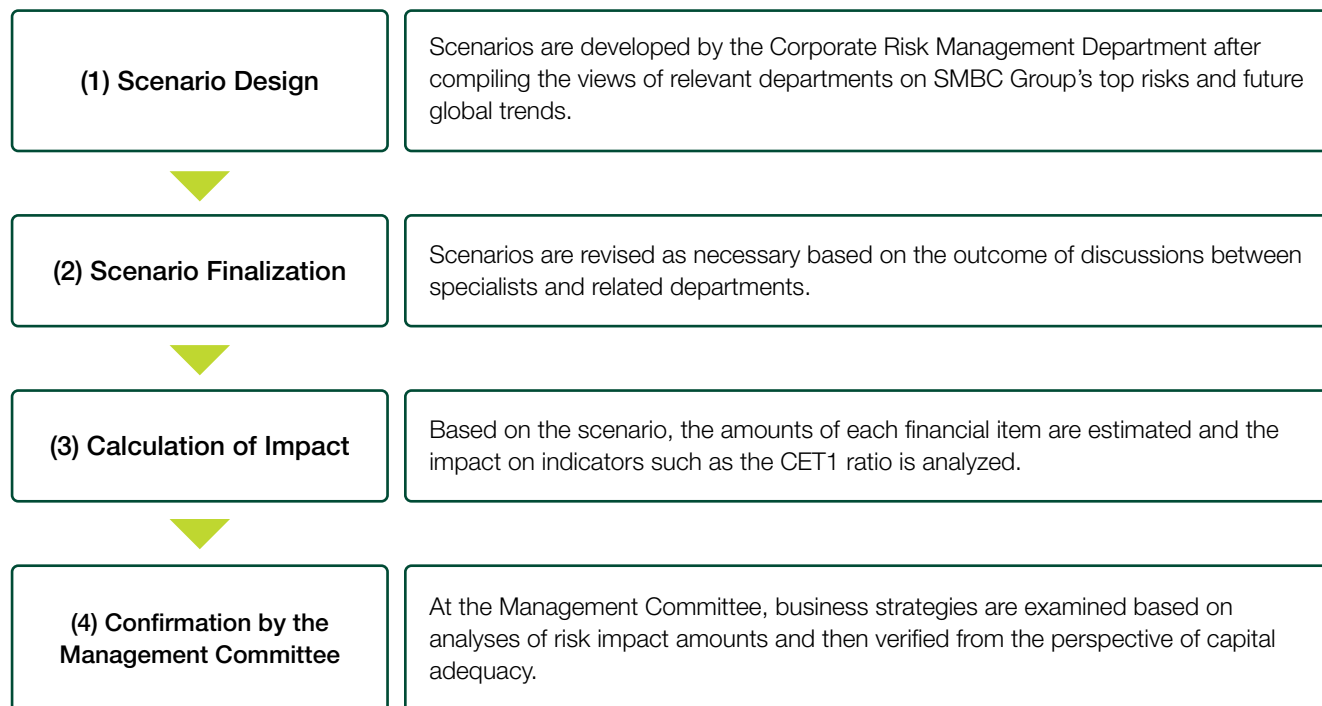
When developing our stress testing methodology, we normally adopt widely accepted statistical techniques. Since it is necessary to estimate outliers under stressed condi-

tions, we do not always select methods with high statistical accuracy, but sometimes based on the ability to reproduce those outliers. Moreover, because some scenarios are with no historical precedent, it is permitted to override the model's estimates with expert judgments when necessary.

In this manner, stress testing processes often require a variety of expertise. When selecting the background conditions for scenarios, expertise regarding macroeconomic conditions and geopolitical risks is required.

When selecting methodologies, insight into the statistical and other mathematical analysis techniques is crucial. When calculating impacts on SMBC Group as a whole, insight into SMBC Group and the businesses of its customers must be used. Stress testing processes will thus be based on discussions and opinions of directors, members of upper management, specialists, and representatives from relevant organizations and records will be created of these discussions and opinions in order to ensure objectivity, transparency, and reproducibility. In this way, measures for practicing proper governance of stress testing will be applied.

■ Stress Testing Process



Risk-Weighted Assets

Risk-weighted assets under the Basel III framework as of the end of March 2025 increased by 268.6 billion yen from the end of March 2024 to 93,117.1 billion yen. The main factors causing fluctuations in risk assets are increases in domestic and overseas credit balances, the impact of yen appreciation, and stock price declines.

■ Risk-Weighted Assets as of March 31, 2025

(Trillion of yen)

| | End of March 2024 | End of March 2025 | Increase (decrease) |
|--------------------|----------------------|----------------------|------------------------|
| Credit risk | 84.3 | 83.9 | (0.5) |
| Market risk | 2.9 | 3.1 | +0.2 |
| Operational risk | 5.5 | 6.2 | +0.6 |
| Floor adjustments* | 0.0 | 0.0 | ±0.0 |
| Total | 92.8 | 93.1 | +0.3 |

(*) Adjustment amount due to the difference between the internal model approach and the standardized approach

■ Risk Assets of Individual Business Units

(Trillion of yen)

| | | | |
|---|--|-------------------------------------|------|
| SMBC Group Credit Risk 83.9 Market Risk 3.1 Operational Risk 6.2 Floor adjustments 0.0 | | Retail Business Unit | 14.1 |
| | | Wholesale Business Unit | 24.3 |
| | | Global Business Unit | 33.0 |
| | | Global Markets Business Unit | 8.3 |
| | | | |

Credit Risk

1. Basic Approach to Credit Risk Management

(1) Characteristics of Credit Risk

Credit risk is characterized by the possibility of a loss arising from a credit event, such as deterioration in the financial condition of a borrower, that causes an asset (including off-balance sheet transactions) to lose value or become worthless.

(2) Fundamental Principles for Credit Risk Management

All Group companies follow the fundamental principles established by SMBC Group to assess and manage credit risk on a group-wide basis and further raise the level of accuracy and comprehensiveness of group-wide credit risk management. Each Group company must comprehensively manage credit risk according to the nature of its business, and assess and

manage credit risk of individual loans and credit portfolios quantitatively under consistent standards.

Credit risk is the most significant risk to which SMBC Group is exposed. Without effective credit risk management, the impact of the corresponding losses on operations can be overwhelming.

The purposes of credit risk management are to keep credit risk exposure to a permissible level relative to capital, to maintain the soundness of group-wide assets, and to ensure returns commensurate with risk. Doing so leads to a loan portfolio that achieves high returns on capital and assets.

(3) Credit Policy

SMBC Group's credit policy comprises clearly stated universal and basic operating concepts, policies, and standards for credit operations, in accordance with our business mission and rules of conduct. SMBC Group is promoting the understanding of and strict adherence to its Group credit policy among all its managers and employees. By fostering a culture of appropriate levels of risk-taking and providing high-value-added financial services, SMBC Group aims to enhance shareholder value and play a key contributory role in the community.

2. Credit Risk Management System

At SMBC Group, the Group CRO formulates credit risk management policies each year based on the group-wide basic policies for risk management. Meanwhile, the Credit & Investment Planning Department is responsible for the comprehensive management of credit risk. This department drafts and administers credit risk regulations, including the Group credit policies, manages non-performing loans (NPLs), and performs other aspects of credit portfolio management. We have also established the Credit Risk Committee to serve as a body for deliberating on matters related to group-wide credit portfolios.

At SMBC, the core bank of SMBC Group, the Credit & Investment Planning Department within the Risk Management Unit furnishes the credit risk management system and is thus responsible for the comprehensive management of credit risk. This department drafts and administers credit policies, the internal rating system, credit authority guidelines, and credit application guidelines, and also manages NPLs and performs other aspects of credit portfolio management, including active portfolio management using credit derivatives.

The department also cooperates with the Corporate Risk Management Department in quantifying credit risk (risk capital and risk-weighted assets) and controls the bank's entire credit risk.

The credit department in charge, in cooperation with branches, conducts credit risk assessments and manages

credit portfolios within each credit department's jurisdiction. The credit approval authority is determined based on the credit amount and internal grades, while credit departments focus on the analysis and management of customers and transactions with relatively high credit risk. The Credit Administration Department is responsible for handling NPLs of borrowers classified as potentially bankrupt or lower, and draws up plans for their workouts, including write-offs. It works to efficiently reduce the amount of NPLs through Group company SMBC Servicer Co., Ltd., which engages in related services, and by such means as the sell-off of claims. Through industrial and sector-specific surveys and studies of individual companies, the Corporate Research Department works to form an accurate idea of the circumstances of borrower companies and quickly identify those with potentially troubled credit positions as well as promising growth companies.

The Compliance Unit has in place a system of coordinating to establish systems for providing explanations to customers and develop information management practices for the purpose of customer protection and to prevent transactions with antisocial forces, among other tasks.

The Internal Audit Unit, operating independently of the business units, audits asset quality, the accuracy of gradings and self-assessment, and the state of credit risk

management, and reports the results directly to the Audit and Supervisory Committee and the Management Committee.

SMBC has established the Credit Risk Committee as a consultative body to round out its oversight system for undertaking flexible and efficient control of credit risks, and ensuring the overall soundness of the bank's loan operations.

3. Credit Risk Management Methods

(1) Credit Risk Assessment and Quantification

At SMBC Group, to effectively manage the risk involved in individual loans as well as the credit portfolio as a whole, we first acknowledge that every loan entails credit risks, assess the credit risk posed by each borrower and loan using an internal rating system, and quantify that risk for control purposes.

(a) Internal Rating System

There is an internal rating system for each asset control category established according to portfolio characteristics. For example, credits to corporates are assigned an "obligor grade," which indicates the borrower's creditworthiness, and/or "facility grade," which indicates the collectibility of assets taking into account transaction conditions, such as guarantee/collateral, credit period, and tenor. An obligor grade is determined by first assigning a financial grade using a financial strength grading model and data obtained from

■ SMBC's Domestic Obligor Grading System

| Obligor Grade | Definition | Borrower Category | Financial Reconstruction Act Based Disclosure Category |
|---------------|--|--|--|
| 1 | Very high certainty of debt repayment | Normal Borrowers | Normal Assets |
| 2 | High certainty of debt repayment | | |
| 3 | Satisfactory certainty of debt repayment | | |
| 4 | Debt repayment is likely but this could change in cases of significant changes in economic trends or business environment depending on the situation | | |
| 5 | No problem with debt repayment over the short term, but not satisfactory over the mid to long term and the situation could change in cases of any changes in economic trends or business environment | | |
| 6 | Currently no problem with debt repayment, but it is highly likely that this could change in cases of significant changes in economic trends or business environment | | |
| 7 | Close monitoring is required due to problems in meeting loan terms and conditions, sluggish/unstable business, or financial problems (Borrowers Requiring Caution identified as Substandard Borrowers) | Borrowers Requiring Caution Substandard Borrowers | Substandard Loans |
| 8 | Currently, there is no situation of business bankruptcy, but the company is in financial difficulty, and the progress of business improvement plans, etc. is not favorable, and it is recognized that there is a high possibility of falling into bankruptcy in the future | Potentially Bankrupt Borrowers | Doubtful Assets |
| 9 | Although there has been no legal or formal bankruptcy, the company is in a state of serious financial difficulty with no prospect of rehabilitation, and is effectively bankrupt | Virtually Bankrupt Borrowers | Bankrupt and Quasi-Bankrupt Assets |
| 10 | Legally or formally bankrupt | Bankrupt Borrowers | |

the obligor's financial statements. The financial grade is then adjusted taking into account the actual state of the obligor's balance sheet and qualitative factors to derive the obligor grade. In the event that the borrower is domiciled overseas, internal ratings for credit are made after taking into consideration country rank, which represents an assessment of the credit quality of each country, based on its political and economic situation as well as its current account balance and external debt. The borrower categories used in self-assessment are consistent with the obligor grade categories.

Obligor grades and facility grades are reviewed once a year, and whenever necessary, such as when there are changes in the credit situation. There are also grading systems for loans to individuals and project finance and other structured finance tailored according to the risk characteristics of these types of assets.

The Credit & Investment Planning Department centrally manages the internal rating systems and properly designs, operates, supervises, and validates the grading models. It validates the grading models and systems of main assets following the procedures manual (including those for statistical validation) once a year to ensure their effectiveness and suitability and submits reports with this regard. SMBC, the core bank of SMBC Group, employs a total of 28 grading models for corporate, specialized lending, and retail applications. For details on internal rating methods, please refer to Appendix II.

(b) Quantification of Credit Risk

Credit risk quantification refers to the process of estimating the degree of credit risk of a portfolio or individual loan taking into account not just the obligor's Probability of Default (PD) but also the concentration of risk in a specific customer or industry and the loss impact of fluctuations in the value of collateral, such as real estate and securities.

Specifically, first, the PD by grade, Loss Given Default (LGD), credit quality correlation among obligors, and other parameter values are estimated using historical data of obligors and facilities stored in a database to calculate the credit risk. Then, based on these parameters, we run a simulation of simultaneous default using the Monte Carlo method to calculate our maximum loss exposure to the estimated amount of the maximum losses that may be incurred. Based on these quantitative results, we allocate risk capital.

Risk quantification is also executed for purposes such as to determine the portfolio's risk concentration, or to simulate economic movements (stress tests), and the results are used for making optimal decisions across the whole range of business operations, including formulating business plans and providing a standard against which individual credit applications are assessed. For details on internal rating methods, please refer to Appendix II.

(2) Framework for Managing Individual Loans

SMBC Group strives to maintain a sound portfolio through appropriate credit assessments and monitoring conducted over credit periods. The following framework is used for managing individual loans at SMBC, the core bank of SMBC Group.

(a) Credit Assessment

At SMBC, credit assessment of corporate loans involves a variety of financial analyses, including cash flow, to predict an enterprise's capability of loan repayment and its growth prospects. These quantitative measures, when combined with qualitative analyses of industrial trends, the enterprise's R&D capabilities, the competitiveness of its products or services, and its management caliber, result in a comprehensive credit assessment. The loan application is analyzed in terms of the intended utilization of the funds and the repayment schedule. Thus, SMBC is able to arrive at an accurate and fair credit decision based on an objective examination of all relevant factors.

Increasing the understandability to customers of loan conditions and approval standards for specific borrowing purposes and loan categories is a part of SMBC's ongoing review of lending practices, which includes the revision of loan contract forms with the chief aim of clarifying lending conditions utilizing financial covenants.

To respond proactively and promptly to customers' funding needs—particularly those of SMEs—we employ a standardized credit risk assessment process for SMEs that uses a credit-scoring model. With this process, we are building a regime for efficiently marketing our Business Select Loan and other SME loans.

In the field of housing loans for individuals, we employ a credit assessment model based on credit data amassed and analyzed by SMBC over many years. This model enables our loan officers to efficiently make rational decisions on housing loan applications and to reply to the customers without delay. It also facilitates the effective management of credit risk as well as the flexible setting of interest rates.

We also provide loans to individuals who rent out properties such as apartments. The loan applications are subjected to a precise credit risk assessment process utilizing a risk assessment model that factors in the projected revenue from the rental business. We also provide advice to such customers on how to revise their business plans.

(b) Credit Monitoring System

At SMBC, in addition to analyzing loans at the application stage, the Credit Monitoring System is utilized to maintain an understanding of the circumstances surrounding the obligor in order to reassess obligor grades and review self-assessment and credit policies so that problems can be detected at an early stage and quick and effective action can be taken. The system includes periodic monitoring carried out each

time an obligor enterprise discloses financial results as well as continuous monitoring performed each time credit conditions change, as indicated in the diagram below.

(3) Framework for Credit Portfolio Management

In addition to managing individual loans, SMBC Group applies the following basic policies to the management of the entire credit portfolio to maintain and improve its soundness and profitability over the medium to long term. Information on the status of credit portfolio management is reported to the Management Committee and the Board of Directors and regular monitoring is performed through the Risk Appetite Framework (RAF).

(a) Appropriate Risk Control within Capital

To take risks within the acceptable level of capital, we set upper limits for overall risk capital based on the risk appetite and portfolio plan of each business unit and monitor credit risk capital as a breakdown of overall risk capital.

(b) Controlling Concentration Risk

As the equity capital of SMBC Group may be materially impaired in the event that the credit concentration risk becomes apparent, we implement measures to manage credit toward industrial sectors with excessive risk concentration and introduce large exposure limit lines and conduct intensive loan review for obligors with large exposure.

To manage country risk, we also have credit limit guidelines based on each country's creditworthiness.

(c) Researching Borrowers More Rigorously and Balancing Risk and Returns

Against a backdrop of drastic change in the business environment, we rigorously research borrower companies' actual conditions. We run credit operations on the basic principle of earning returns that are commensurate with the credit risk involved, and make every effort to reduce credit

and capital costs as well as general and administrative expenses.

(d) Preventing and Reducing Non-Performing Loans

On NPLs and potential NPLs, we carry out regular loan reviews to clarify handling policies and action plans, enabling it to swiftly implement measures to prevent deterioration of borrowers' business situations, support business recoveries, collect on loans, and enhance loan security.

(e) Actively Managing Portfolios

We engage in flexible portfolio control aimed at stabilization of our credit portfolio through credit control methods.

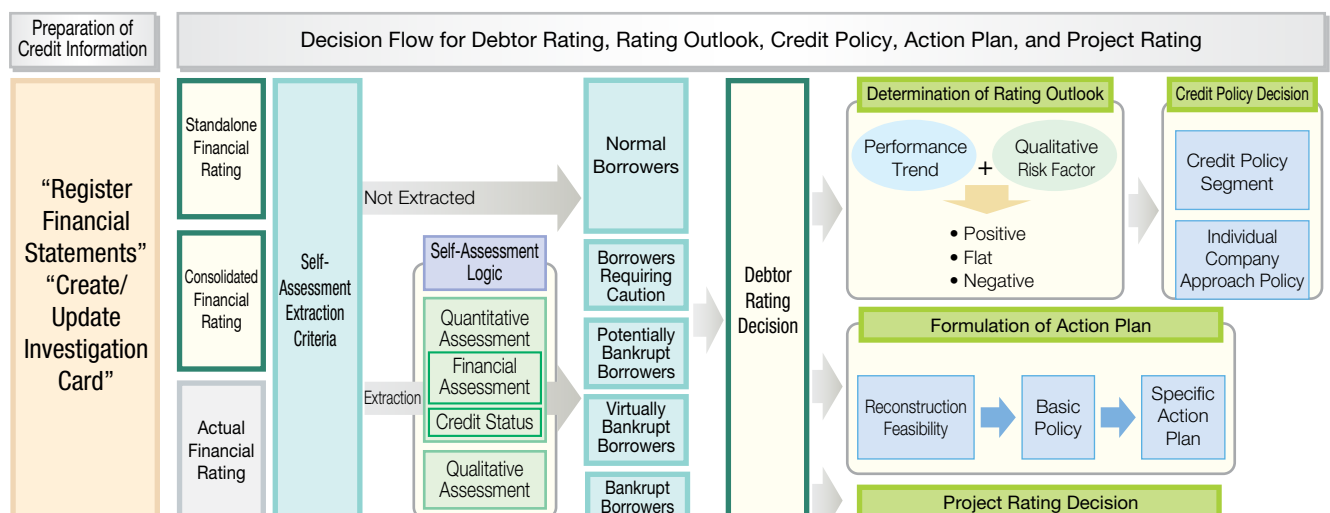
(4) Self-Assessment, Write-Offs and Provisions, Non-Performing Loans Disclosure

(a) Self-Assessment

Self-assessment is a preparatory task for ensuring SMBC Group's asset quality and calculating the appropriate level of write-offs and provisions. Each asset is assessed individually for its security and collectibility. Depending on the borrower's current situation, the borrower is assigned to one of five categories: Normal Borrowers, Borrowers Requiring Caution, Potentially Bankrupt Borrowers, Virtually Bankrupt Borrowers, and Bankrupt Borrowers. Based on the borrower's category, claims on the borrower are classified into Classification I, II, III, and IV assets according to their default and impairment risk levels, taking into account such factors as collateral and guarantees.

Self-assessment is the latter stage of the obligor grading process for determining the borrower's ability to fulfill debt obligations, and the obligor grade criteria are consistent with the categories used in self-assessment. As part of our efforts to bolster risk management throughout SMBC Group, consolidated subsidiaries carry out self-assessment in substantially the same manner.

■ SMBC's Credit Monitoring System



| Borrower Categories, Defined | |
|--------------------------------|--|
| Normal Borrowers | Borrowers with good earnings performances and no significant financial problems |
| Borrowers Requiring Caution | Borrowers identified for close monitoring |
| Potentially Bankrupt Borrowers | Borrowers perceived to have a high risk of falling into bankruptcy |
| Virtually Bankrupt Borrowers | Borrowers that may not have legally or formally declared bankruptcy but are essentially bankrupt |
| Bankrupt Borrowers | Borrowers that have been legally or formally declared bankrupt |

| Asset Classifications, Defined | |
|---------------------------------|--|
| Classification I (Unclassified) | Assets not classified under Classifications II, III, or IV |
| Classification II | Assets perceived to have an above-average risk of uncollectibility |
| Classification III | Assets for which final collection or asset value is very doubtful and which pose a high risk of incurring a loss |
| Classification IV | Assets assessed as uncollectible or worthless |

(b) Write-Offs and Provisions

In cases in which claims have been determined to be uncollectible or deemed to be uncollectible, write-offs signify the recognition of losses on the account books with respect to such claims. Write-offs can be made either in the form of loss recognition by offsetting uncollectible amounts against corresponding balance sheet items, referred to as a direct write-off, or else by recognition of a loan loss provision on a contra-asset account in the amount deemed uncollectible, referred to as an indirect write-off. Recognition of indirect write-offs is generally known as provision for the reserve for possible loan losses.

The write-off and provision standards and procedures for each self-assessment borrower category at SMBC, the core bank of SMBC Group, are shown on the right. As part of our overall measures to strengthen credit risk management throughout SMBC Group, all consolidated subsidiaries use substantially the same standards as SMBC for write-offs and provisions.

| SMBC's Standards for Write-Offs and Provisions | |
|--|---|
| Normal Borrowers | The expected loss amount for the next one year is calculated for each grade based on historical bankruptcy rates and recorded as a provision for the general reserve for possible loan losses (Note 1). |
| Borrowers Requiring Caution | Assets are grouped according to the level of default risk, and for each group, the expected future loss amount is calculated based on historical bankruptcy rates* and recorded as a provision for the general reserve for possible loan losses (Note 1). Further, when cash flows can be estimated reasonably accurately, the discounted cash flow (DCF) method is applied mainly to large claims for calculating the provision amount. * Grouping is divided into "claims on Substandard Borrowers" and "claims on other Borrowers Requiring Caution." The latter group is further subdivided according to the borrower's financial position, credit situation, and other factors. |
| Potentially Bankrupt Borrowers | For each borrower, the necessary amount for Classification III (excluding portions expected to be recovered through collateral, guarantees, etc.) is calculated and recorded as a specific reserve for possible loan losses (Note 2). Further, when cash flows can be estimated reasonably accurately, the DCF method is applied mainly to large claims for calculating the provision amount. |
| Virtually Bankrupt / Bankrupt Borrowers | For each borrower, the full amount of Classification IV (deemed to be uncollectible or of no value) is, in principle, directly written off, and the full amount of Classification III is recorded as a specific reserve for possible loan losses (Note 2). Further, when cash flows from future reconstruction can be estimated reasonably accurately, the DCF method is applied mainly to large claims for calculating the provision amount. |
| Note 1: General Reserve for Possible Loan Losses | Provisions made for the general inherent risk of uncollectibility in loan claims, without identifying individual claims. |
| Note 2: Specific Reserve for Possible Loan Losses | Provisions made for claims (individually evaluated) that are recognized as uncollectible in whole or in part. |
| <p>* Discounted Cash Flow Method</p> <p>SMBC uses the discounted cash flow (DCF) method to calculate the provision amounts for large claims on Substandard Borrowers or below when the cash flow from repayment of principal and interest received can be estimated reasonably accurately. SMBC then makes provisions equivalent to the excess of the book value of the claims over the said cash inflow discounted by the initial contractual interest rate or the effective interest rate at the time of origination. One of the major advantages of the DCF method over conventional methods of calculating the provision amount is that it enables effective evaluation of each individual borrower. However, as the provision amount depends on the future cash flow estimated on the basis of the borrower's business reconstruction plan and the DCF formula input values, such as the discount rate and the probability of the borrower going into bankruptcy, SMBC makes every effort to utilize up-to-date and correct data to realize the most accurate estimates possible.</p> | |
| <p>* Forward-Looking Provisions</p> <p>SMBC records general reserves in amounts deemed necessary through comprehensive judgments to prepare for future losses in accordance with forecasts for specific portfolios with a high likelihood of occurrence and that cannot be reflected in past performance or in the borrower categories of specific companies based on recent operating environment and risk trends.</p> | |

(c) Non-Performing Loans Disclosure

Non-Performing Loans are loans and other claims of which recovery of either principal or interest appears doubtful. In disclosing Non-Performing Loans, the disclosure category is determined by the borrower categories assigned during self-assessment, and are disclosed as Non-Performing Loans based on the Banking Act and the Reconstruction Act.

4. Risk Management of Marketable Credit Transactions

Financial products, such as investments in funds, securitized products, and credit derivatives, that bear indirect risk arising from underlying assets such as bonds and loan obligations are considered to be exposed to both credit risk from the underlying assets as well as “market risk” and “liquidity risk” that arise from their trading as financial products. This is referred to as marketable credit risk.

For these types of products, we manage credit risk by analyzing and assessing the characteristics of the underlying assets, but, for the sake of complete risk management, we also apply the methods for management of market and liquidity risks.

In addition, we have established guidelines based on the characteristics of these types of risks and appropriately manage the risk of losses.

Market and Liquidity Risks

1. Basic Approach to Market and Liquidity Risk Management

(1) Definitions of Market and Liquidity Risks

Market risk is the possibility that fluctuations in interest rates, foreign exchange rates, equity prices, or other market prices will change the market value of financial products, leading to a loss.

Liquidity risk is defined as the uncertainty around the ability of the firm to meet debt obligations without incurring unacceptably large losses. Examples of such risk include the possible inability to meet current and future cash flow/collateral needs, both expected and unexpected. In such cases, the firm may be required to raise funds at less than favorable rates or be unable to raise sufficient funds for settlement.

(2) Fundamental Principles for Market and Liquidity Risk Management

SMBC Group is working to further enhance the effectiveness of its quantitative management of market and liquidity risks across the entire Group by setting allowable risk limits; ensuring the transparency of the risk management process; and clearly separating front-office, middle-office, and back-office operations to establish a highly efficient system of mutual checks and balances.

2. Market and Liquidity Risk Management System

In accordance with the group-wide basic policies for risk management decided upon by the Management Committee, SMBC Group determines important matters relating to the management of market and liquidity risks, such as basic policies and risk limits, in order to manage these risks. The ALM Committee meets four times a year, in principle, to report on the state of market and liquidity risk management and to discuss ALM operation policies. The Corporate Risk Management Department and the Risk Management Information Department which are independent of the business units that directly handle market transactions, manage market and liquidity risks in an integrated manner. These departments not only monitor the current risk situation but also regularly report to the Management Committee and the Board of Directors. Furthermore, the ALM Committee at SMBC, the core bank of SMBC Group, meets on a monthly basis to examine reports on the state of observance of limits on market and liquidity risks and to discuss ALM operation policies.

The Audit Department conducts regular internal audits to verify that these risk management systems are functioning properly.

3. Market and Liquidity Risk Management Methods

(1) Market Risk Management

SMBC Group manages market risk by controlling amounts of value at risk (VaR), losses, and risk capital based on consideration for the Group's shareholders' equity and other principal indicators of the Group's Financial position and management resources, business policies pertaining to market transactions and market liquidity.

Market risk can be divided into various factors: foreign exchange rates, interest rates, equity prices, and option risks. SMBC Group manages each of these risk categories by employing VaR as well as supplemental indicators suitable for managing the risk of each risk factor, such as the BPV.

Trading activities are market operations that gain profits by taking advantage of fluctuations in market prices over the short term or price differences among markets. We assess and manage the market risk of trading activities on a daily basis by utilizing VaR and other tools. Banking activities are market operations which gain profits by controlling interest rates and term period for assets (loans, bonds, etc.) and liabilities (deposits, etc.). In the same way as in the case of trading activities, we assess and manage the market risk of banking activities on a daily basis, utilizing VaR and other tools.

The risk of interest rate fluctuation differs substantially depending on the method for recognizing maturity dates of demand deposits (current accounts and ordinary deposit accounts that can be withdrawn at any time) and the method for estimating the time of cancellation prior to maturity of time deposits and consumer loans. At SMBC, the

maturity of demand deposits that are expected to be left with the bank for a prolonged period is assumed to be up to 5 years (2.5 years on average). The cancellation prior to maturity of time deposits and consumer loans is estimated based on historical data.

(a) Market Risks

a. Trading activities

Trading activities are market operations that gain profits by taking advantage of fluctuations in market prices over the short term or price differences among markets. At SMBC Group, we assess and manage the market risk of trading activities on a daily basis by utilizing VaR and other tools.

The following table shows the VaR results of the Group's trading activities during fiscal 2024.

b. Banking activities

Banking activities are market operations which gain profits by controlling interest rates and term period for assets

(loans, bonds, etc.) and liabilities (deposits, etc.). At SMBC Group, in the same way as in the case of trading activities, we assess and manage the market risk of banking activities on a daily basis, utilizing VaR and other tools.

The following table shows the VaR results of the Group's banking activities during fiscal 2024.

(b) Market Risk Measurement Model

a. Overview

SMBC Group uses an internal model to measure VaR. In our internal VaR model, various market fluctuation scenarios are drawn up on the basis of past data, and the historical simulation method is used to run profit-and-loss movement simulations that enable us to forecast probable maximum losses. The appropriateness of the internal model is verified through back-testing. Additionally, this model undergoes regular audits by an independent auditing firm and has been evaluated as appropriate.

■VaR for Trading Activities

(Billions of yen)

| | Fiscal 2024 | | | | | End of March 2024 |
|--|-------------------|-----------------------|---------|---------|---------|-------------------|
| | End of March 2025 | End of September 2024 | Maximum | Minimum | Average | |
| Sumitomo Mitsui Financial Group (consolidated) | 40.8 | 42.7 | 61.8 | 38.4 | 42.1 | 40.0 |
| Interest rates | 18.3 | 19.7 | 24.1 | 17.8 | 19.5 | 19.5 |
| Foreign exchange | 7.1 | 7.3 | 8.4 | 4.5 | 6.5 | 5.2 |
| Equities, commodities, etc. | 22.1 | 22.6 | 43.8 | 15.3 | 22.7 | 21.4 |
| SMBC (consolidated) | 23.9 | 23.2 | 26.9 | 17.8 | 22.6 | 17.5 |
| SMBC (non-consolidated) | 4.4 | 5.2 | 6.7 | 3.5 | 5.0 | 3.8 |

(Note) 1. VaR for a one-day holding period with a one-sided confidence interval of 99.0% [computed daily using the historical simulation method (based on four years of historical observations)].

2. For products and positions to which the historical simulation method is not applied, the amount of risk measured by a reasonable and conservative method is simply added to the amount of risk by the historical simulation method.

■VaR for Banking Activities

(Billions of yen)

| | Fiscal 2024 | | | | | End of March 2024 |
|--|-------------------|-----------------------|---------|---------|---------|-------------------|
| | End of March 2025 | End of September 2024 | Maximum | Minimum | Average | |
| Sumitomo Mitsui Financial Group (consolidated) | 63.4 | 67.9 | 96.3 | 59.5 | 75.0 | 95.1 |
| Interest rates | 62.5 | 61.6 | 82.1 | 57.6 | 68.2 | 79.6 |
| Equities, etc. | 32.7 | 18.8 | 35.8 | 12.6 | 28.0 | 31.8 |
| SMBC (consolidated) | 62.3 | 66.5 | 94.7 | 58.2 | 73.7 | 93.5 |
| SMBC (non-consolidated) | 49.5 | 54.2 | 80.9 | 45.2 | 60.2 | 79.2 |

(Note) 1. VaR for a one-day holding period with a one-sided confidence interval of 99.0% [computed daily using the historical simulation method (based on four years of historical observations)].

2. For products and positions to which the historical simulation method is not applied, the amount of risk measured by a reasonable and conservative method is simply added to the amount of risk by the historical simulation method.

3. Strategic shareholdings are not included in the above equities.

b. Validity verification process

SMBC Group conducts back-testing on major portfolios as a procedure for verifying of the internal model. Specifically, we compare the figures calculated by the internal model with the losses of the target portfolio on a daily basis to confirm the appropriateness of the model and the adequacy of risk capital management.

We also regularly conduct verification and analysis related to the autocorrelation of risk factors and the effect of the observation period to confirm the validity of the model.

c. Substitute indicators

SMBC Group employs, as substitute indicators, VaR wherein presumptions for the model (observation periods, etc.) change.

d. Changes in model from fiscal year 2023

There have been no changes in the model from fiscal year 2023.

(c) Stress Testing

The market occasionally undergoes extreme fluctuations that exceed projections. To manage market risk, therefore, it is important to run simulations of unforeseen situations that may occur in financial markets (stress testing). SMBC Group conducts stress tests regularly, assuming various scenarios, and has measures in place for irregular events.

(d) Management of Equity Holdings

SMBC Group establishes risk allowance limits for total risk capital to control equity price fluctuation risk appropriately. Risk capital associated with equity holdings is monitored as a component of total risk capital. More specifically, VaR (1 year holding period) computed from profit-and-loss simulations based on historical market fluctuation data and aggregated fluctuation in market price from the beginning of the fiscal year are subject to the risk capital management and monitored on a daily basis.

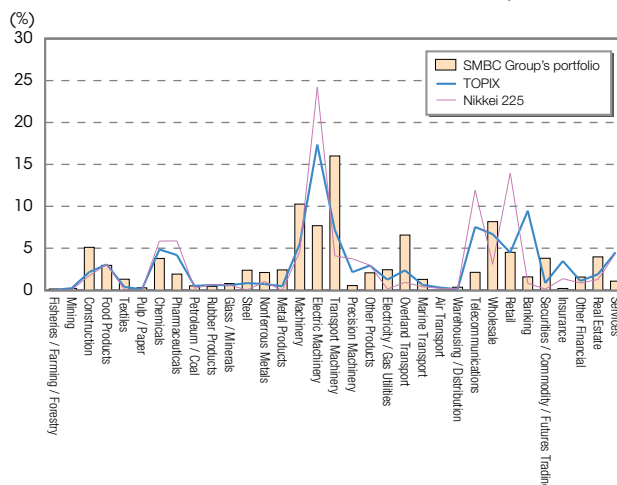
Since our plan to reduce equity holdings by ¥200 billion (*) over three years from the end of March 2023 was achieved 1.5 years ahead of schedule, we announced a plan in November 2024 to reduce holdings by ¥600 billion (*) over five years from the end of March 2024, and achieved a reduction of ¥185 billion in FY2024.

If the plan is successful, we expect a cumulative reduction of equity holdings of more than 90% since the establishment of Sumitomo Mitsui Banking Corporation, and to reduce the market value of our equity holdings to less than 20% of our consolidated net assets during the period of the next Medium-Term Management Plan.

(*) The book value of Japanese listed equities held by SMBC Group.

■ Composition, by Industry, of Listed Equity Portfolio

(March 31, 2025)



(2) Liquidity Risk Management

At SMBC Group, liquidity risk is regarded as one of the major risks. The Group's liquidity risk management is based on a framework consisting of setting Risk Appetite Measures and establishing contingency plans.

The Risk Appetite Measures are measures for selecting the types and levels of risk that we are willing to take on or tolerate. As the level of liquidity risk is evaluated based on cash flow and balance sheet conditions, Risk Appetite Measures have been set for both of these areas. These measures include Liquidity Coverage Ratio and Net Stable Funding Ratio, a liquidity regulation. Measures are set to ensure it will be possible to maintain funding levels even under stress due to deposit outflow or other factors, and to ensure the ratio maintains stable funding to cover loans.

The tolerated levels of risk are set based on account funding status, cash management planning, economic environments, and other factors, and measures are monitored on a daily or monthly basis in order to limit reliance on short-term funding and appropriately manage liquidity.

As a framework to complement the Risk Appetite Measures, upper limits are set in place on both a Group company basis and an individual branch basis with regard to funding gaps, which is defined as a maturity mismatch between the source of funds and use of funds.

Furthermore, contingency plans are established in preparation for emergency situations. These plans contain information on chains of command and lines of reporting as well as detailed action plans depending on the existing situation (i.e., normal, concerned, or critical). Meanwhile, SMBC carries out quantitative management of alert indications based on early warning indicators established to assist the bank in promptly and systematically detecting liquidity risks.

Operational Risk

1. Basic Approach to Operational Risk Management

(1) Definition of Operational Risk

Operational risk is the risk of loss arising from inadequate or failed internal processes, people, and systems or from external events. Specifically, the risk—which, in addition to processing risk and system risk, covers legal risk, human resources risk, and tangible asset risk, and third party risk—consists of the following seven event types that may lead to the risk of loss defined in the Basel Capital Accord: (1) internal fraud, (2) external fraud, (3) employment practices and workplace safety, (4) clients, products, and business practices, (5) damage to physical assets, (6) business disruption and system failures, and (7) execution, delivery, and process management.

(2) Fundamental Principles for Operational Risk Management

SMBC Group has set the policies on Operational Risk Management that stipulate basic matters in the conduct of operational risk management. Following these policies, we are enhancing operational risk management across the Group under basic principles that include the establishment of an effective framework for identifying, assessing, controlling, and monitoring material risks and the establishment of an incident response structure and emergency response structure in preparation for the materialization of risks. Based on the framework of Basel Capital Accord, we continuously strive to raise the level of risk management across the Group.

2. Operational Risk Management System

SMBC Group has developed an operational risk management structure atop the Risk Management Principle Policy. Our basic policy for operational risk management is decided by the Group Management Committee and approved by the Board of Directors.

The Corporate Risk Management Department and the Risk Management Information Department oversee management of operational risks overall, working with departments responsible for subcategories such as processing risk and system risks to comprehensively manage operational risks. The Internal Audit Department conducts periodic internal audits to verify that this operational risk management structure functions properly.

3. Operational Risk Management Methodology

SMBC Group manages internal loss data and key risk indicators (KRI), and creates risk registers. Internal loss data is defined as “information on the events in which the Bank incurs losses due to operational risk.” We examine measures for prevention of recurrence by analyzing collected data and perform risk management based on loss events that have occurred. KRI shall be the monitoring indicator to ascertain the symptoms of the potential operational risks and to ensure effective control for them. When risks are considered to have heightened, we analyze the causes and formulate improvement measures. At the end of March 2024, SMBC Group adopted the standardised approach for calculating the operational risk equivalent amount under Basel Capital Accord.

4. Processing Risk Management

Processing risk is the risk of losses arising from the failure of directors and employees to perform administrative duties in accordance with administrative rules and procedures, or from accidents or misconduct.

SMBC Group has clarified the divisions responsible for the oversight functions for processing risk management, and we are working to raise the level of sophistication of our management of processing risk across the whole Group on a risk basis by establishing systems for managing the processing risks faced by Group companies, ensuring in-office

| Risk Category | Definition | Department in Charge |
|----------------------|--|--|
| Operational risk | The risk of loss arising from inadequate or failed internal processes, people, and systems or from external events. | Corporate Risk Management Department Risk Management Information Department |
| Processing risk | The risk of losses arising from the failure of directors and employees to perform administrative duties in accordance with administrative rules and procedures, or from accidents or misconduct. | Operations Planning Department |
| System risk | The risk arising from nonconformity to the business strategies, inappropriate technologies applied, changes to the development plan and delay in development when building an information system, and the risk of loss incurred due to the breakdown including those caused by cyber attack, malfunction, deficiency, or unauthorized use (unauthorized alteration, destruction, duplication, and leakage of the information). | IT Planning Department |
| Legal risk | The risk of compensation of damages arising from insufficient legal consideration or breach of contract, or a surcharge, a forfeit or an administrative fine for infringing the laws and regulations. | Compliance Department |
| Human resources risk | The risk of loss arising from inappropriate labor practices, poor working environments, discriminatory conduct, an outflow or loss of human resources, or deterioration in employee morale. | Human Resources Department |
| Tangible asset risk | The risk of loss arising from damage to tangible assets or deterioration in the operational environment caused by disasters or inadequate asset maintenance. | CRE & Facility Planning Department |
| Third party risk | The risk of loss arising from damage due to negative incidents caused by third parties who have business relationship with SMBC Group. | Corporate Risk Management Department |

inspection, minimizing losses in the event of processing risk materialization by drafting exhaustive contingency plans, and carrying out thorough quantification of the risk under management as basic principles.

Basic policies for processing risk management are decided by the Management Committee and then approved by the Board of Directors. The status of processing risk management is reported to the Management Committee and the Board of Directors regularly and when necessary. These and other steps are taken to ensure that we can provide customers with high-quality services.

Based on the group-wide basic policies for risk management, Group companies promote appropriate operating practices by establishing operating rules and regulations, systematizing transaction processing, receiving guidance from business divisions, and inspecting conditions related to transaction processing.

5. System Risk Management

System risk is the risk arising from nonconformity to business strategies, inappropriate technologies applied, changes to the development plan and delays in development when building an information system, and the risk of loss incurred due to system breakdown including those caused by cyber attack, malfunction, deficiency or unauthorized use (unauthorized alteration, destruction, duplication and leakage of information).

SMBC Group recognizes systems as an integral part of our management strategy. Our basic principles are to minimize system risks and to minimize losses if a system risk materializes. To achieve this, we have established various regulations and specific management standards, including a security policy, and have developed contingency plans for system failures and cyberattacks. Thus, we have established a system risk management framework and are implementing appropriate risk management measures.

Making reference to The Center for Financial Industry Information Systems (FISC) safety measures standards and U.S. safety measures standards (NIST SP800), we continuously improve our management standards. Across Group companies that require advanced risk management and our supply chains overall, we are strengthening our management, addressing areas in order of their level of risk.

Furthermore, as we actively and openly incorporate technological evolution and advance digitalization in every field to improve customer convenience, create new businesses beyond the boundaries of finance, and improve productivity and efficiency, we are taking steps to identify newly arising risks and to implement management systems that match the extent of these risks. SMBC Group is strengthening IT governance across the Group. As SMBC Group adopts AI (generative AI), cloud, RPA, low-code, API, and other

technologies, we have established guidelines that define necessary countermeasure standards and monitoring procedures specific to the risks associated with these technologies. We are implementing timely and appropriate risk management that addresses technological and environmental changes.

The risk from cyber threats is becoming increasingly severe amid the expansion of areas targeted by cyber attacks due to the acceleration of digitalization in financial services and heightening geopolitical tensions. In preparation against this growing threat, SMBC Group has developed technical measures related to cyber security and a structure for intelligence functions and security monitoring, while working to develop related expert human resources. We regularly participate in training and exercises for the enhancement of effectiveness, and undergo third-party evaluations of our response structure.

SMBC recognize the significant social impact that system failures at banks can cause, as well as the diversification and increasing complexity of system risks due to advances in IT technology and the expansion of business fields. We consider the stable operation and prompt recovery of information systems to be a critical responsibility. To this end, we have implemented various measures to prevent system failures, including the multiplexing of various systems and infrastructure, and the installation of disaster-prevention systems at our eastern and western computer centers. In addition, we are strengthening our preparedness for unforeseeable circumstances by creating contingency plans and conducting drills that simulate system failures. Additionally, recognizing the importance of information protection, we take all possible measures to ensure the protection of customer privacy and prevent information leaks. This includes encrypting sensitive information and implementing measures to block and detect unauthorized external access.

Operational Resilience

1. Basic Approach to Operational Resilience

(1) Definition of Operational Resilience

Operational resilience is the ability to ensure the continuity and prompt recovery of critical operations on the premise that business interruptions may occur.

(2) Basic Principles of Operational Resilience

SMBC Group has established the “Rules on Operational Resilience Management”, which set out the fundamentals for managing operational resilience, we are working to ensure effective operational resilience by verifying the appropriateness of resource allocated to managing critical operations and reviewing it based on the internal and external environment.

2. Operational Resilience Management Structure

SMBC Group has established an operational resilience management structure based on the group-wide policies for risk management.

In addition, the Corporate Risk Management Department and General Affairs Department perform a central role in operational resilience management, collaborating with departments responsible for critical operations and resource management to promote and support measures related to the overall operational resilience framework and policies.

3. Operational Resilience Management Methodology

SMBC Group identifies critical operations that could pose significant risks should service interruptions occur, sets maximum tolerable downtime alongside considering alternative measures, and identifies essential management resources for the provision of critical operations. Furthermore, we assume severe but plausible scenarios and verify the appropriateness of management resource allocation.

We also review actual incidents such as natural disasters and system failures and leverage the lessons learned to enhance overall resilience. Through these initiatives, we continuously strengthen our framework to ensure the stability of services provided to our customers.

Conduct Risk

1. Basic Approach to Conduct Risk Management

(1) Definition of Conduct Risk

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

(2) Fundamental Principles of Conduct Risk Management

SMBC Group's fundamental stance is that its business is not to negatively affect customers, market integrity, effective competition, public interests, and stakeholders. Efforts are being made to improve group-wide conduct risk management. Focuses of these efforts include preemptively identifying phenomena with the potential to cause significant deterioration in the trust of the Group and preventing the materialization of serious management risks by being keenly responsive to environmental changes.

2. Conduct Risk Management System

Based on the group-wide basic policies for risk management, SMBC Group has developed a conduct risk management system. The Management Committee makes decisions on basic policies for conduct risk management, and these decisions are authorized by the Board

of Directors. In addition, the Corporate Risk Management Department and the Compliance Department oversee the overall management of conduct risks and promote basic conduct risk management policies, frameworks, and measures. In addition, these bodies report on circumstances pertaining to conduct risk management to the Audit Committee and Risk Committee and discuss these circumstances to ensure the effectiveness of conduct risk management. Furthermore, the Internal Audit Unit verifies and evaluates the conduct risk management system.

3. Conduct Risk Management Methodology

Using frameworks including risk registers, new product and service development, compliance-related monitoring, and collection of customer voice, each business unit in SMBC Group identifies conduct risks inherent in their operations/initiatives, formulates control measures corresponding to the degree of materiality, and undertakes risk reduction and control.

Risk management departments verify the sufficiency of identified risks and corresponding control measures assessed by business units.

We also work to prevent misconduct through the practice of business units' risk ownership and our supports for this practice.

Risks for AI Utilization

1. Basic Approach to Risk Management for AI Utilization

(1) Definition of Risks for AI Utilization

Risks for AI utilization refer to risks where ethical and technical issues or applicability inherent in AI utilization act as risk drivers, spreading across various risk categories in different forms, and ultimately adversely affecting SMBC Group and stakeholders. Specifically, these include uncertainty, lack of rationale, low accuracy, information leakage, and rights infringement regarding AI outputs, but risks are not limited to these as they change with shifts in the environment and technological advances.

(2) Fundamental Principles of Risk Management for AI Utilization

SMBC Group has formulated and published the "Responsible AI Policy," which is based on the core principles of "Using AI Ethically and Responsibly," "Providing Highly Safe and Trustworthy AI," and "Creating Social Value through AI" as common guidelines.

2. Risk Management System for AI Utilization

SMBC Group has established a system to manage risks for AI utilization based on the group-wide basic policies for risk management.

In addition, since risks arising from AI utilization are diverse, the Corporate Risk Management Department, as the central department, forms a governance team together with the IT Planning Department, Cybersecurity Management Department, Data Management Department, General Affairs Department, and Compliance Department, all of which have relevant expertise, to plan and promote risk management for AI utilization.

3. Risk Management Methodology for AI Utilization

SMBC Group manages and reviews AI utilization projects to prepare for issues such as ethics and transparency inherent in AI. We conduct reviews based on a risk-based approach and strive to ensure effectiveness.

Furthermore, to address the increasing risks associated with the rapid development and expansion of AI technology, we will continue to work on the swift advancement of risk management for AI utilization.

Model Risk

1. Basic Approach to Model Risk Management

(1) Definition of Model Risk

Model risk is the risk of potential adverse consequences or financial loss resulting from misinformed decision making based on inaccurate model outputs or using the model inappropriately.

(2) Fundamental Principles of Model Risk Management

SMBC Group is working to improve model risk management across the Group by adhering to basic principles such as performing management based on a risk-based approach, evaluating model risk and carrying out quantitative management.

2. Model Risk Management System

SMBC Group has established a system for managing model risk based on the group-wide basic policies for risk management. The Management Committee makes decisions on basic policies for model risk management, and these decisions are authorized by the Board of Directors.

In addition, the Corporate Risk Management Department centrally oversees model risk management and is responsible for drafting model risk management plans, as well as

their operation, promotion and support. The Internal Audit Department carries out regular audits of the efficacy of the model risk management system.

3. Model Risk Management Methodology

SMBC Group strives to reduce model risk by implementing appropriate controls for each process of model development and usage. This is to prepare for the emergence of model risks due to financial and economic environments beyond that anticipated when developing the model and due to the improper use of models by employees. For example, we carry out validations during the development of models or when we start to use them, and periodic validation throughout model lifecycle to prevent their obsolescence or deterioration of their accuracy. In addition, we also strive to strengthen risk management according to model importance by assessing the risks present in each model.

Reputational Risk

1. Basic Approach to Reputational Risk Management

(1) Definition of Reputational Risk

Reputational risk refers to the risk of not meeting the expectations for high ethics, integrity, etc. by the stakeholders (that is, customers, shareholders, market, society, environment, employees, etc.) due to the business of the SMBC Group and the behavior of employees and other related parties, as well as of leading to impairment of the Enterprise Value and decline in trust.

(2) Fundamental Principles of Reputational Risk Management

SMBC Group has set forth the rules on Reputational Risk Management to define the basic rules to be observed in the conduct of its reputational risk management. Under these rules, SMBC Group has been working to enhance the reputational risk management framework across the whole Group by clarifying a management structure as well as management system, methodologies, and rules.

2. Reputational Risk Management System

Based on the group-wide basic policies for risk management, SMBC Group has developed a reputational risk management system.

In addition, General Affairs Department and Public Relations Department control the reputational risk management in a centralized manner and formulate and operate the

plan for reputational risk management, promote and provide support for the related matters as well as summarize and analyze information related to reputational risk. The matter leading to the reputational risk is discussed in the reputational risk management committee to consider various measures to minimize the risk, as necessary.

3. Methods of Reputational Risk Management

SMBC Group minimizes the losses by adequately gathering information about the situations where reputational risk could materialize as well as taking proper measures against such situations.

General Affairs Department and Public Relations Department strive to control and reduce the risk by gathering information about the situations where reputational risk could materialize and taking proper measures against the reputational risk matters identified.

Environmental and Social Risk

1. Basic Approach to Environmental and Social Risk Management

(1) Definition of Environmental and Social Risk

Environmental and social risks are the risks that environmental and social factors become risk drivers and transmit through various pathways to each risk category, ultimately resulting in losses to the SMBC Group. Specifically, risks such as climate-related risks, nature-related risks, and human rights risks are subject to management.

| Risk | Definition |
|---|--|
| Climate-related risks (transition risks and physical risks) | the risks that the SMBC Group incurs losses initiated by changes related to climate change which transmit to each risk category through various pathways |
| Nature-related risks | the risks that the SMBC Group may incur losses due to potential threats arising from its dependence on and influence on nature which transmit to each risk category through various pathways |
| Human rights risks | the risks that the SMBC Group may incur losses as a result of violations of the human rights of stakeholders which transmit to each risk category through various pathways |

(2) Basic Principles of Environmental and Social Risk Management

SMBC Group has established Group Policies on Environmental and Social Risk Management that stipulate basic matters for carrying out environmental and social risk management. We are working to enhance environmental and social risk management throughout the Group by clarifying our management structure and basic concepts such as understanding the transmission pathways of environmental and social risks in the management of each risk, recognizing the location of environmental and social risks, and implementing appropriate management according to the risk characteristics.

2. Environmental and Social Risk Management System

SMBC Group has developed an environmental and social risk management system based on the group-wide basic policies for risk management. The Management Committee makes decisions on basic policies for environmental and social risk management, and these decisions are authorized by the Board of Directors. The Audit Department conducts audits of our risk management structure. The Environmental & Social Risk Management Department of the Credit & Investment Planning Department oversees environmental and social risk management overall. Each risk management department is responsible for managing each risk category to which environmental and social factors transmit as risk drivers.

3. Methods of Environmental and Social Risk Management

SMBC Group has identified top risks that could have a significant impact on management, such as reputational damage and emergence of stranded assets due to diverse views on environmental and human rights issues and inadequate responses to climate change. As a specific management method, in response to environmental and social risks above that transmit to credit risks, we set policies for specific businesses and sectors, undertake customer engagement through environmental and social due diligence that includes assessment of transition plans and human rights due diligence, and work to enhance credit assessment. In the area of climate-related risks, we manage portfolio GHG emissions through our climate-related RAF, create heat maps that evaluate risks by sector, and conduct scenario analysis of physical risks and transition risks.

Glossary

ALM

Asset Liability Management abbreviation.

Method for comprehensive management of assets and liabilities, with appropriate controls on market risk (interest rates, exchange rates, etc.) and liquidity risk.

Back-testing

A formal statistical framework that consists of verifying that actual losses are in line with projected losses.

For example, in the case of VaR, compare and verify the VaR value and profit/loss.

BPV

Basis Point Value abbreviation.

Potential change in present value of financial product corresponding to 0.01 -percentage-point increase in interest rates.

Credit cost

Average losses expected to occur during the coming year.

Historical simulation method

Method of simulating future fluctuations without the use of random numbers, by using historical data for risk factors.

LGD

Abbreviation for Loss Given Default.

Percentage of loss assumed in the event of default by obligor; ratio of uncollectible amount of the exposure owned in the event of default.

Monte Carlo simulation method

General term used for a simulation method which uses random numbers.

Operational Risk Equivalent Amount

The amount of regulatory capital required under the Basel regulations for operational risk.

PD

Abbreviation for Probability of Default.

Probability of default by the obligor during one year.

Present value

A future amount of money that has been discounted to reflect its current value taking into account the interest rate and the extent of credit risk.

Risk appetite

The types and levels of risk that we are willing to take on or tolerate to drive earnings growth.

Risk capital

The amount of capital required to cover the theoretical maximum potential loss arising from risks of business operations. It differs from the minimum regulatory capital requirements, and it is being used in the risk management framework voluntarily developed by financial institutions for the purpose of internal management.

Risk factor

In the case of market risk, this would be factors such as the equity price or interest rate; in the case of credit risk, this would be factors such as the economic environment.

Risk-weighted assets

The denominator used in the calculation of the capital ratio designed to maintain prudential standards for banks.

Standardised approach

A method for calculating operational risk equivalent amounts by multiplying the amount of the Business Indicator Component (BIC) by the Internal Loss Multiplier (ILM).

VaR

Value at Risk abbreviation.

The maximum loss that can be expected to occur with a certain degree of probability when holding a financial asset portfolio for a given amount of time.

