Risk Management

Basic Principles

Financial and economic deregulation, globalization, and advances in IT are generating new business opportunities for financial institutions. The risks accompanying these new business opportunities are not only increasing in number but also growing in diversity and complexity. Accordingly, identifying, measuring, and controlling risks have never been more important in the management of a financial holding company.

SMFG has encapsulated the basic principles to be employed in risk management in the manual entitled *Regulations on Risk Management*. In the manual, we have specified the basic policies for risk management: 1) Set forth SMFG's Groupwide basic policies for risk management after specifying the categories of risk to which these policies apply; 2) Provide all necessary guidance to Group companies to enable them to follow the basic risk management policies set forth by SMFG and set up their own appropriate risk management systems; 3) Monitor the implementation of risk management by all Group companies to ensure that their practices meet the relevant standards.

Types of Risk, and Risk Management System

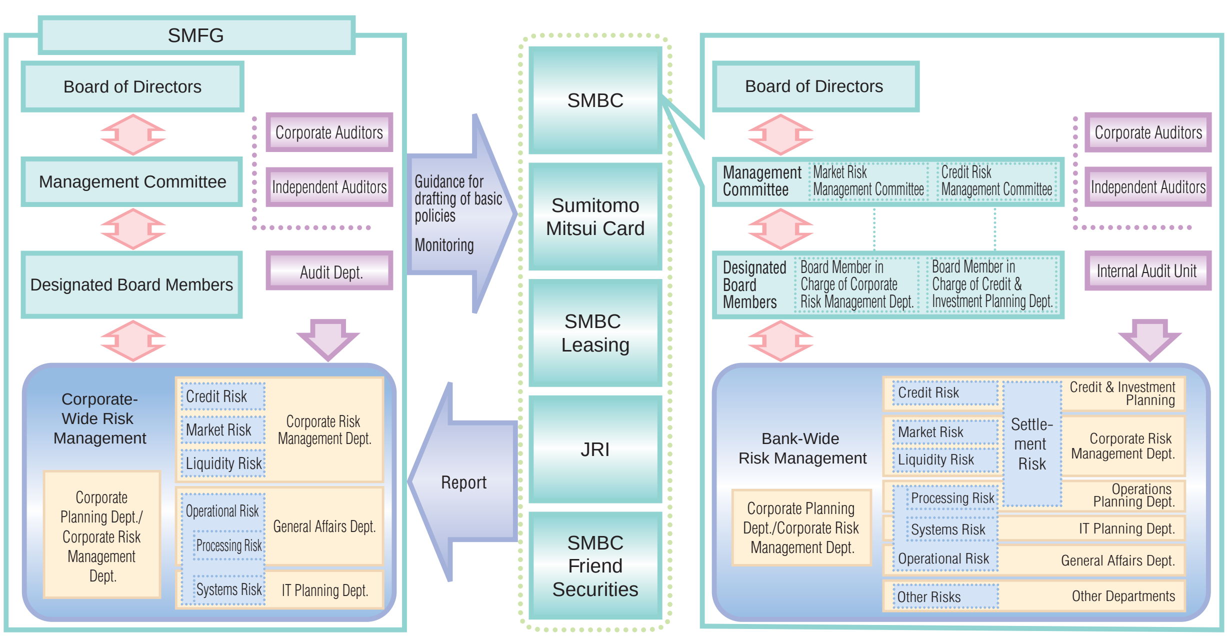
At SMFG, we classify risk into the following categories: (1) credit risk, (2) market risk, (3) liquidity risk and (4) operational risk (including processing risk and systems risk). In addition, we provide individually tailored guidance to help Group companies identify categories of risk that need to be addressed. Risk categories are constantly reviewed, and new categories may be added in response to changes in the operating environment. The Corporate Risk Management Department works with the Corporate Planning Department to comprehensively and systematically manage all these categories of risk across the entire Group.

Top management plays an active role in determining SMFG's Groupwide basic policies for risk management. The system works as follows: The basic policies for risk management are determined by the Management Committee before being authorized by the Board. The Management Committee, the designated Board members, and the relevant risk management departments perform risk management according to the basic policies.

Risk management systems are in place at the individual Group companies in accordance with SMFG's Groupwide basic policies for risk management. For example, at SMBC, specific departments have been appointed to oversee the handling of the four risk categories listed above, in addition to risks associated with settlement. Each risk category is managed taking into account the particular characteristics of that category. In addition, the Corporate Risk Management Department—independent of the operating units—comprehensively and systematically manages all categories of risk in cooperation with the Corporate Planning Department.

Furthermore, under our system top management plays an active role in the drafting of basic policies of risk management. The decision-making process for addressing credit, market and liquidity risks at the operating level is strengthened by the Credit Risk Management Committee and the Market Risk Management Committee, which are subcommittees of the Management Committee. The Management Committee is also attended by the relevant department heads.

■ **SMFG's Risk Management System**



Risk Management Methods

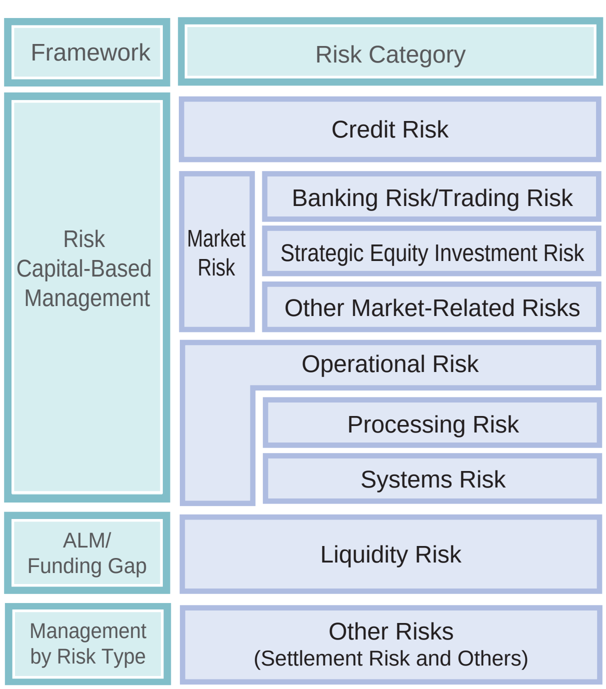
SMFG's Groupwide basic policies for risk management stipulate the basic risk management regulations that must be followed, and spell out risk management procedures from various perspectives. These include managing risk on a consolidated accounting basis, managing risk using quantification methods, ensuring consistency with business strategies, setting up a system of checks and balances, contingency planning for emergencies and serious situations, and verifying preparedness to handle all conceivable risk situations. In addition, there are specific operational policies for implementing appropriate management of risk by all Group companies.

Under SMFG's Groupwide basic policies for risk management, all Group companies periodically carry out reviews of the basic management policies for each risk category, or whenever deemed necessary, thus ensuring that the policies followed at any time are the most appropriate. The management of SMFG constantly monitors the conduct of risk management at Group companies, providing guidance when necessary.

Furthermore, in order to maintain a balance between risk and return as well as ensure the soundness of the Group from an overall perspective, we employ the risk capital-based management method, which allocates capital effectively to each department according to its role in our business strategies to keep total exposure to credit, market, and operational risks within the scope of our management resources, i.e., capital.

In the case of SMBC, for example, sufficient capital is allocated to cover the bank's exposure to credit, market, and operational risks. In the credit and market risk categories, in particular, the maximum risk capital that SMBC can use during a period is set as the risk capital limit within this limit to manage these risks. Liquidity risk is managed within the context of maximum limits set for asset liability management (ALM) and the funding gap. Other risk categories are managed with procedures closely attuned to the nature of the risk, as described in the following paragraphs.

■ Relationship between Risk Management Framework and Risk Category at SMBC



Implementation of Basel II

The Basel Capital Accord, an international agreement for ensuring the soundness of banks through adherence to BIS capital adequacy regulations, was revised in response to the diversification of the banking business and the increasing sophistication of risk management technology. The revised BIS regulations, known as Basel II, became effective from March 31, 2007 in Japan.

Basel II requires banks to implement internal controls to serve as the basis for capital calculation, and to strengthen their risk management framework. It also requires disclosure of information to encourage market discipline in risk management.

We have been implementing initiatives to strengthen our risk management framework, taking into account Basel II and other considerations. Details of the initiatives are provided below, and detailed information on the capital ratio is provided in the discussion on Capital Ratio Information appearing in the Financial Section.

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. Overseas credits also include an element of country risk, which is closely related to credit risk. This is the risk of loss caused by changes in foreign exchange, or political or economic situations.

All Group companies follow the basic policy established by SMFG to assess and manage credit risk on a Groupwide basis and further raise the level of accuracy and comprehensiveness of Groupwide 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 and using consistent standards. Credit risk is the most significant risk to which SMFG is exposed. Without effective credit risk management, the impact of the corresponding losses on operations can be overwhelming.

The purpose of credit risk management is to keep credit risk exposure to a permissible level relative to capital, to maintain the soundness of assets, and to ensure returns commensurate with risk. This leads to a loan portfolio that achieves high returns on capital and assets.

SMBC's credit management policy and system are described below.

1. Credit Policy

SMBC's credit policy comprises clearly stated universal and basic operating concepts, policies, and standards for credit operations, in accordance with the business mission and rules of conduct. SMBC is promoting the understanding of and strict adherence to its credit policy among all its managers and employees. By conducting risk-sensitive credit management in accordance with Basel II and other capital adequacy regulations, SMBC aims to enhance shareholder value and play a key part in society by providing high value-added financial services.

2. Credit Risk Assessment and Quantification

To effectively manage the risk involved in individual loans as well as the credit portfolio as a whole, SMBC first acknowledges that every loan entails credit risks, assesses the credit risk posed by each borrower and loan using an internal rating system, and quantifies that risk for control purposes.

(1) Internal Rating System

There is an internal rating system for each asset control category set according to portfolio characteristics. For example, credits to commercial and industrial (C&I) companies, individuals for business purposes (domestic only), sovereigns, public sector entities, and financial institutions are assigned an "obligor grade" which indicates the borrower's creditworthiness, and/or "facility grade" which indicates the collectability of assets taking into account transaction conditions such as guarantee/collateral, and tenor. An obligor grade is determined by first assigning a financial grade using a financial strength grading model and data obtained from 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 risk, 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. Self-assessment is the obligor grading process for assigning lower grades, and the borrower categories used in self-assessment are consistent with the obligor grade categories.

■ SMBC's Obligor Grading System

Obligor Grade		Definition	Borrower Category	Financial Reconstruction Law Based Disclosure Category (Domestic)
Domestic (C&I), etc.	Overseas (C&I), etc.			
J1	G1	Very high certainly of debt repayment	Normal Borrowers	Normal Assets
J2	G2	High certainty of debt repayment		
J3	G3	Satisfactory certainty of debt repayment		
J4	G4	Debt repayment is likely but this could change in case of significant changes in economic trends or business environment		
J5	G5	No problem with debt repayment over the short term, but not satisfactory over the medium-to-long term and the situation could change in the event of significant changes in economic trends or business environment.		
J6	G6	Currently no problem with debt repayment, but there are unstable business and financial factors that could lead to debt repayment problems		
J7	G7	Close monitoring is required due to problems in meeting loan terms and conditions, sluggish/unstable business, or financial problems	Borrowers Requiring Caution	
J7R	G7R	(Substandard Borrowers)	Substandard Borrowers	Substandard Loans
J8	G8	Currently not bankrupt, but experiencing business difficulties, making insufficient progress in restructuring, and highly likely to go bankrupt	Potentially Bankrupt Borrowers	Doubtful Assets
J9	G9	Though not yet legally or formally bankrupt, has serious business difficulties and rehabilitation is unlikely; thus, effectively bankrupt	Effectively Bankrupt Borrowers	Bankrupt and Quasi-Bankrupt Assets
J10	G10	Legally and formally bankrupt	Bankrupt Borrowers	

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 SME (Small and Medium Enterprise) loans, 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 (including statistical validation) of main assets following the procedures manual once a year, to ensure their effectiveness and suitability.

(2) Quantification of Credit Risk

Credit risk quantification refers to 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, the PD by grade, LGD (loss given default), 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. The PD and LGD values are, in principle, the same values as those used for calculating the capital ratio. Based on these parameters, we run a simulation of 10,000 iterations of simultaneous default using the Monte Carlo method to calculate our maximum loss exposure. This quantification enables effective risk capital allocation.

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.

3. Framework for Managing Individual Loans

(1) Credit Assessment

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.

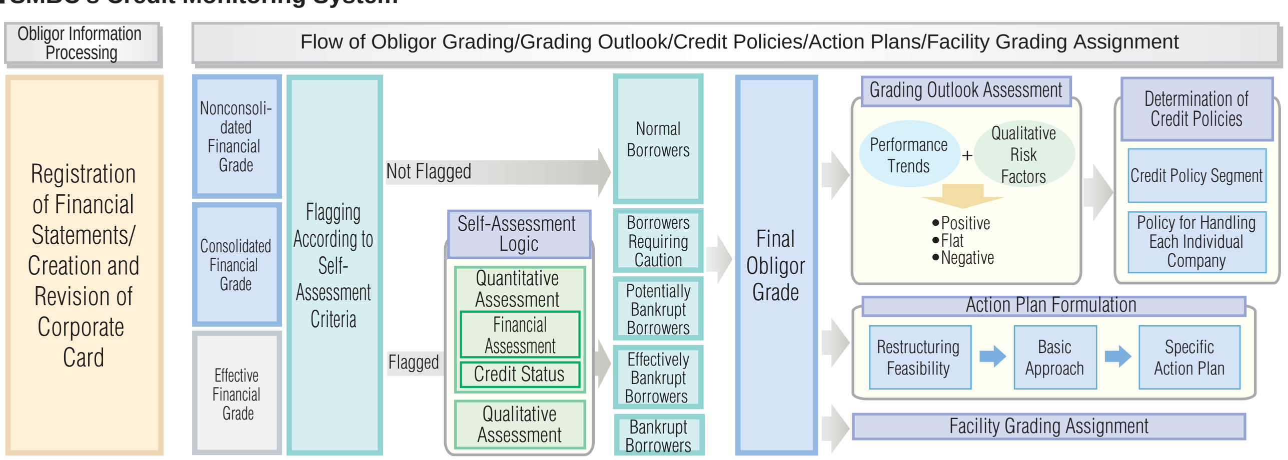
Increasing the understandability of loan conditions and approval standards for specific borrowing purposes and loan categories is a part of SMBC's ongoing review of lending practices, which includes the revision of loan contract forms with the chief aim of clarifying lending conditions utilizing financial covenants. SMBC is also making steady progress in rationalizing its credit assessment process.

To respond proactively and promptly to customers' funding needs—particularly those of small and medium-sized enterprises (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

■ **SMBC's Credit Monitoring System**



model that factors in the projected revenue from the rental business. The process is also used to provide advice to such customers on how to revise their business plans.

(2) Credit Monitoring System

In addition to analyzing loans at the application stage, the Credit Monitoring System is utilized 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.

4. Framework for Credit Portfolio Management

In addition to managing individual loans, SMBC 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.

(1) Risk-Taking within the Scope of Capital

To keep credit risk exposure to a permissible level relative to capital, SMBC sets credit risk capital limits for internal control purposes. Under these limits, separate guidelines are issued for each business unit and marketing unit. Also issued are specialized guidelines for each business unit and business type, such as real estate finance, fund investment, and investment in securitization products. Regular monitoring is conducted to make sure that these guidelines are being followed, thus ensuring appropriate overall management of credit risk.

(2) Controlling Concentration Risk

Because concentration of credit risk in an industry or corporate group has the potential to substantially impair capital, SMBC implements measures to prevent excessive concentration of loans in an industry and to control large exposure to individual companies or corporate groups by setting guidelines for maximum loan amounts. To manage country risk, SMBC also has credit limit guidelines based on each country's creditworthiness.

(3) New Type of Unsecured Loans, and Balancing Risk and Returns

Against the background of increasing sophistication in methods of managing credit risk, SMBC is engaged in a new type of unsecured loans. Meanwhile, the bank runs credit operations on the basic principle of earning returns that are commensurate with the credit risk involved, and makes every effort to reduce capital and credit costs as well as general and administrative expenses.

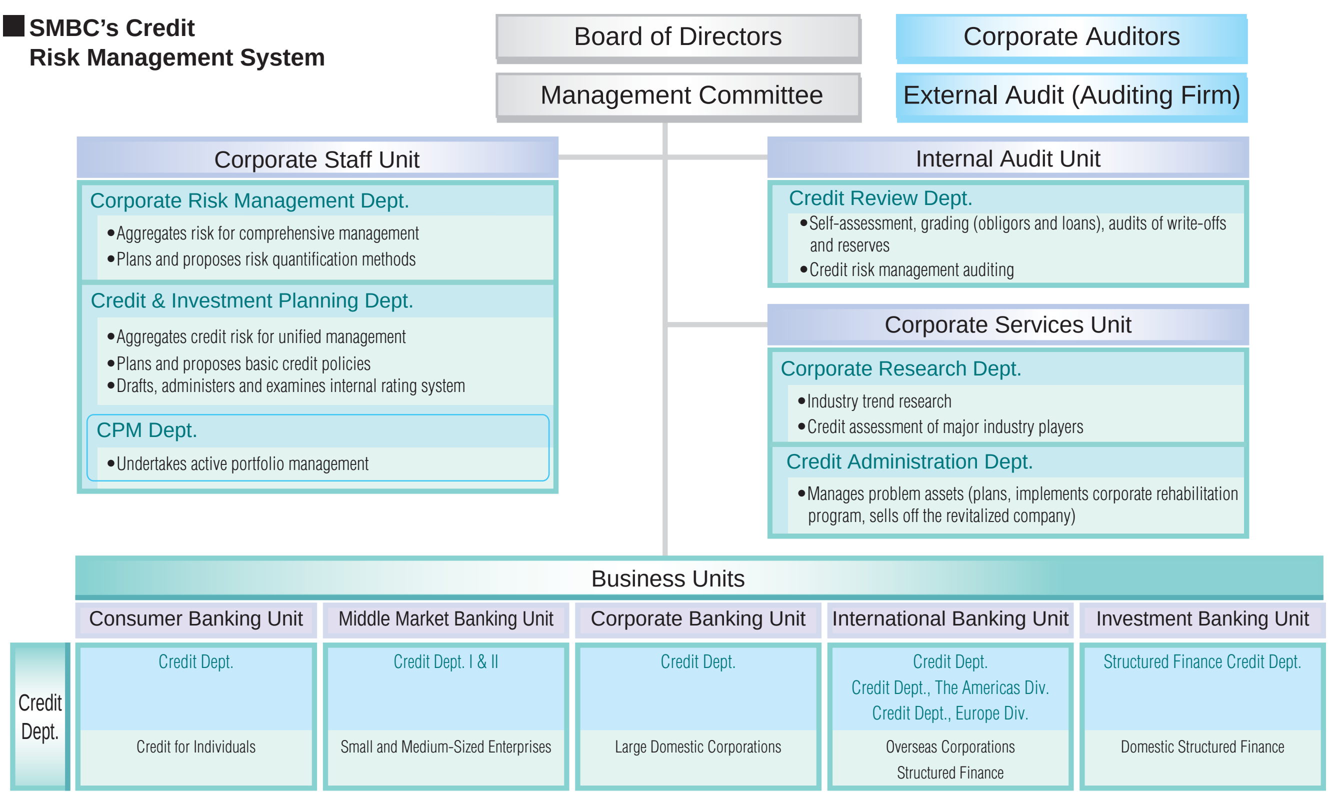
(4) Reduction and Prevention of Non-Performing Loans

On non-performing loans (NPLs) and potential NPLs, SMBC carries 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.

(5) Toward Active Portfolio Management

SMBC makes active use of credit derivatives, loan securitization, and other instruments to proactively and flexibly manage its portfolio to stabilize credit risk.

■ SMBC's Credit Risk Management System



5. Credit Risk Management System

The Credit & Investment Planning Department within the Corporate Staff Unit is responsible for the comprehensive management of credit risk. This department drafts and administers credit policies, the internal rating system, credit authority guidelines, credit application guidelines, and manages NPLs and other aspects of credit portfolio management.

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. Further, the Corporate Portfolio Management Department within the Credit & Investment Planning Department has been strengthening its active portfolio management function whereby loan securitization and other market transactions are used to stabilize the portfolio's credit risk for more sophisticated portfolio management.

The Corporate Research Department within the Corporate Services Unit performs research on industries as well as investigates the business situations of borrower enterprises to detect early signs of problems or growth potential. 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, and corporate rehabilitation. The department closely liaises with the Group company SMBC Business Servicing Co., Ltd., which engages in related services, and works to efficiently reduce the amount of NPLs by such means as the sell-off of claims.

The credit departments within each business unit conduct credit risk management for loans handled by their units and manage their units' portfolios. The credit limits they use are based on the baseline amounts established for each grading category, with particular attention paid to evaluating and managing customers or loans perceived to have particularly high credit risk.

The Credit Review Department, operating independently of the business units, audits asset quality, accuracy of gradings, self-assessment, and state of credit risk management, and reports the results directly to the Board of Directors 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 risk, and ensuring the overall soundness of the bank's loan operations.

Market and Liquidity Risks

Market and Liquidity Risk Management System

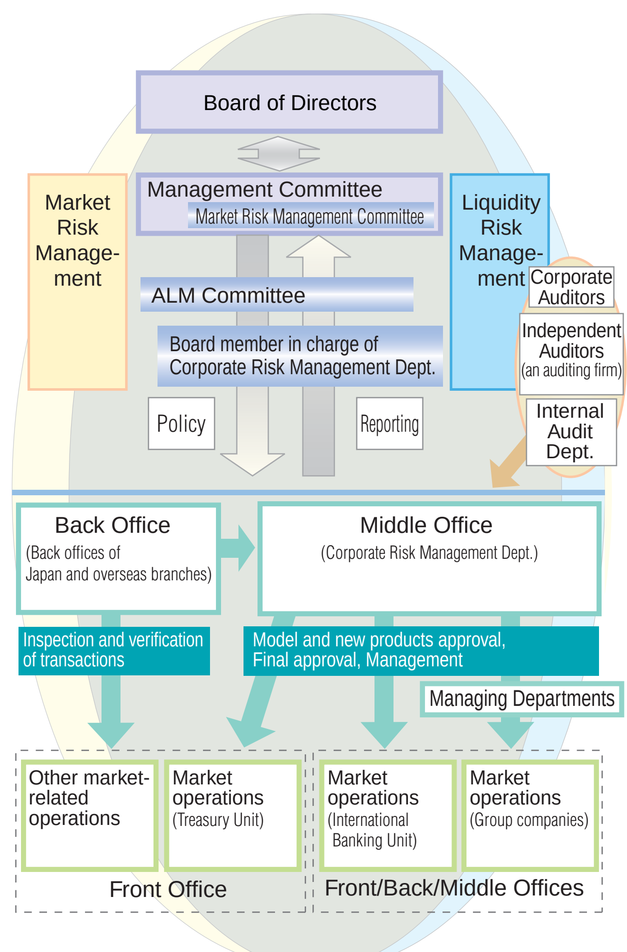
Market risk is the possibility that fluctuations in interest rates, foreign exchange rates, or stock prices will change the market value of financial products, leading to a loss.

Liquidity risk is the possibility of encountering an obstacle to raising the funds required for settlement due either to a mismatch between the use and procurement of funds or to an unexpected outflow of funds, or being forced to borrow at higher interest rates than usual.

SMFG 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; clearly separating front-office, middle-office, and back-office operations; and establishing a highly efficient system of mutual checks and balances.

On the basis of SMFG's Groupwide basic policies for risk management, SMBC's Board of Directors authorizes important matters relating to the management of market and liquidity risks, such as basic policies and risk limits, which are decided by the Management Committee. Additionally, the bank's Corporate Risk Management Department, which is independent of business units that directly handle market transactions, manages market and liquidity risks in an integrated manner. The department not only monitors the current risk situations, but also reports regularly to the Management Committee and the Board of Directors. Furthermore, SMBC's ALM Committee meets on a monthly basis

■ SMBC's Market Risk and Liquidity Risk Management Organization Chart



to examine reports on the state of observance of the bank's limits on market and liquidity risks, and to review and discuss the bank's ALM policies.

To prevent unforeseen processing errors as well as fraudulent transactions, it is important to establish a system of checks on the business units (front office). At SMBC, both the processing departments (back office) and the administrative departments (middle office) conduct the checks. In addition, SMBC's independent Internal Audit Unit periodically performs comprehensive internal audits to verify that the risk management system is functioning properly.

Market Risk

The bank manages market risk by setting maximum limits for value-at-risk (VaR) and maximum loss. This is done using the VaR method, in which the maximum potential loss on market transactions for a given probability is calculated. These limits are, themselves, set within the "market risk capital limit," which is determined taking into account the bank's shareholders' equity and other principal indicators of the bank's financial position and management resources.

The SMBC VaR model estimates the maximum loss by running simulations of changes in profit and loss on market fluctuation scenarios based on historical data (historical simulation method).

Market risk can be divided into various factors: foreign exchange rate, interest rate, equity price, and option risks. Fine-tuned management of each risk category is achieved by employing the VaR method in conjunction with suitable indicators for managing the risk of individual financial instruments such as the basis-point-value (BPV) indicator, which measures the potential change in earnings stated at market value for every 0.01 percentage-point fluctuation in interest rates. The VaR results for fiscal 2006 are shown below.

The internal model used by SMBC (SMBC VaR) has been periodically evaluated by an independent auditing firm and certified as appropriate. In addition, the relationship between the VaR calculated with the model and the actual profit and loss data is back-tested daily. The back-testing results for SMBC's trading accounts for fiscal 2006 are shown below. A data point below the diagonal line indicates a loss in excess of the predicted VaR for that day: there were no such excess losses during fiscal 2006. This demonstrates that the SMBC VaR model, with a one-sided confidence interval of 99.0%, is sufficiently reliable.

The market occasionally undergoes extreme fluctuations that exceed projections. To manage market risk, therefore, it is important to run simulations of situations that may occur only once in many years (stress tests). At SMBC, monthly stress tests using scenarios of past market fluctuations, those not related to past

■ VaR Results

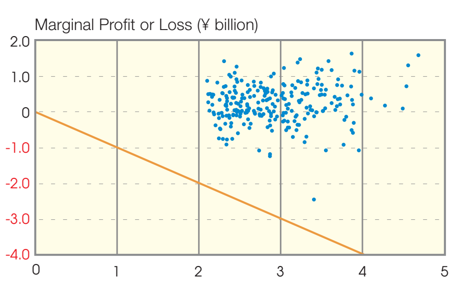
(Billions of yen)

	SMFG (consolidated)		SMBC (consolidated)		SMBC (non-consolidated)	
	Trading Book	Banking Book	Trading Book	Banking Book	Trading Book	Banking Book
June 2006	2.1	57.0	2.1	53.2	1.6	45.3
Sept. 2006	2.9	42.8	2.9	39.7	2.4	35.1
Dec. 2006	3.1	47.1	3.1	43.5	2.6	39.3
Mar. 2007	2.9	47.6	2.9	44.1	2.3	39.8
Maximum	4.7	78.9	4.7	75.5	4.2	69.1
Minimum	2.1	36.8	2.1	33.4	1.5	29.4
Average	2.9	51.6	2.9	48.1	2.5	43.0

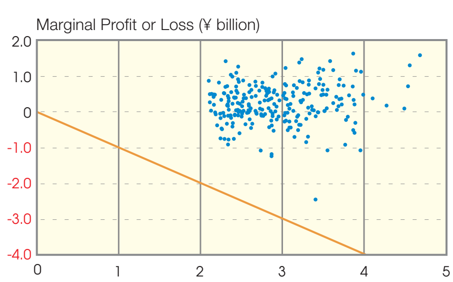
(VaR for a one-day holding period with one-sided confidence interval of 99.0% [computed daily using historical simulation (based on four years of historical observations)]. The VaR model for the trading book includes principal consolidated subsidiaries. Figures for the trading book exclude specific risks.)

■ Back-Testing Results (Trading Book)

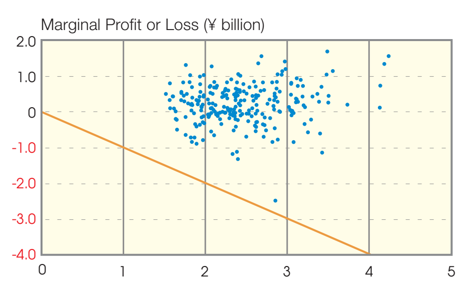
1. SMFG (consolidated)



2. SMBC (consolidated)



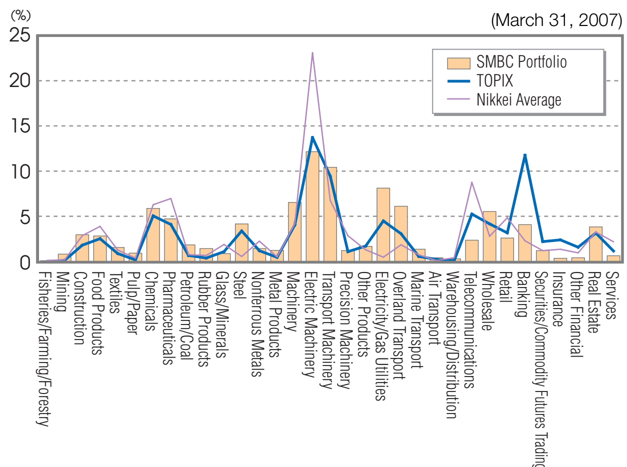
3. SMBC (non-consolidated)



market fluctuations, and specific-factor driven market fluctuations are conducted to prepare for unforeseeable swings.
The Corporate Risk Management Department establishes limits on allowable risk for strategic equity investments, and monitors the observance of those limits to keep stock price fluctuation risk within acceptable parameters.

SMBC aims to keep the stock price fluctuation risk associated with its strategic equity investments at a level appropriate to the financial strength of the bank. To achieve this, we have been reducing the balance of our stock holdings, and the balance now stands at approximately 50% of Tier I capital.

Composition, by Industry, of Listed Equity Portfolio



Liquidity Risk

At SMBC, liquidity risk is regarded as one of the major risks. So as not to be overly dependent on market-based funding to cover short-term cash outflows, SMBC's liquidity risk management is based on a framework consisting of setting funding gap limits and guidelines, maintaining a system of highly liquid supplementary funding sources, and establishing contingency plans.

In daily risk management operations, SMBC prevents a cumulative increase in liquidity risk by setting the funding gap limits and guidelines. For emergency situations, there are contingency plans in place to reduce the funding gap limits and guidelines and other measures. To prevent the possibility of market crises interfering with funding, SMBC carries highly liquid assets, such as U.S. Treasury securities, and has emergency borrowing facilities in place, which also enable foreign currency-denominated liquidity management.

Operational Risk

Operational risk is the possibility of losses arising from inadequate or failed internal processes, people and systems or from external events. SMFG has drawn up the *Regulations on Operational Risk Management* to define the basic rules to be observed in the conduct of operational risk management across the entire Group. Under these regulations, SMFG is working to raise the level of sophistication of its management of operational risk across the whole Group by providing an effective framework for the identification, assessment, control and monitoring of significant risk factors and by establishing a system for executing contingency and business continuity plans.

Moreover, in view of the fact that operational risk is assessed as a regulatory factor under the Basel II capital adequacy framework, we have implemented an operational risk quantification system, and a sophisticated management system for the entire Group.

On the basis of SMFG's Groupwide basic policies for risk management, SMBC Board of Directors authorizes important matters relating to management of operation risk, such as basic policies, which are decided by the Management Committee.

Further, the Operational Risk Management Department, set up within the bank's General Affairs Department, is responsible for centrally supervising overall operational risk management. It works together with the Corporate Risk Management Department, which is responsible for the quantification of operational risk, and with the departments specifically responsible for controlling processing risk and systems risk. The independent Internal Audit Unit periodically performs comprehensive internal audits to verify that the operational risk management system is functioning properly.

Specifically, operational risk is managed by collecting and analyzing internal loss data, comprehensively identifying risk scenarios in each business process by regularly conducting risk control assessments, and estimating loss severity and frequency for each risk scenario. Each risk scenario is assessed for its impact, and each branch/department establishes a risk reduction plan for high-impact scenarios. The Operational Risk Management Department then reviews the implementation of the reduction plan, and uses the collected internal loss data and scenarios to quantify operational risk in order to quantitatively manage operational risk.

The occurence of internal loss data, scenarios determined from risk control assessments, and risk reduction situations are regularly reported to the director in charge of the Operational Risk Management Department. Additionally the Operational Risk Committee, whose members are drawn from all relevant departments of the bank, also meets regularly to discuss ways of minimizing operational risk and realizing a highly effective operational risk management framework. The operational risk situation is also reported to the Management Committee and the Board of Directors on a regular basis, for review of the basic policies on operational risk management.

Processing Risk

Processing risk is the possibility of losses arising from negligent processing by employees, accidents, or unauthorized activities.

SMFG recognizes that all operations entail processing risk. We are therefore working to raise the level of sophistication of our management of processing risk across the whole Group by ensuring that each branch conducts its own regular investigations of processing risk; minimizing losses in the event of processing errors or negligence by drafting exhaustive contingency plans; and carrying out thorough quantification of the risk under management.

In the administrative regulations of SMBC, in line with SMFG's Groupwide basic policies for risk management, the basic administrative regulations are defined as "comprehending the risks and costs of administration and transaction processing, and managing them accordingly," and "seeking to raise the quality of administration to deliver high-quality service to customers." Adding new policies or making major revisions to existing ones for processing risk management requires the approval of both the Management Committee and the Board of Directors.

In the administrative regulations, SMBC has also defined specific rules for processing risk management. The rules allocate processing risk management tasks among six types of departments: operations planning departments, compliance departments, operations departments, transaction execution departments (primarily front-office departments, branches, and branch service offices), internal audit departments, and the customer support departments. In addition, there is a specialized group within the Operations Planning Department to strengthen administrative procedures throughout the Group.

Systems Risk

Systems risk is the possibility of a loss arising from the failure, malfunction, or unauthorized use of computer systems. SMFG recognizes that reliable computer systems are essential for the effective implementation of management strategy in view of the IT revolution. We strive to minimize systems risk by drafting regulations and specific management standards, including a security policy. We also have contingency plans with the goal of minimizing losses in the event of a system failure. The development of such a systems risk management system ensures that the Group as a whole is undertaking adequate risk management.

At SMBC, safety measures are strengthened according to risk assessment based on the Financial Services Agency's *Financial Inspection Manual*, and the *Security Guidelines* published by The Center for Financial Industry Information Systems (FISC).

Computer-related trouble at financial institutions now has greater potential to impact the public, with systems risk diversifying owing to the IT revolution, and the resulting expansion of networks and the rise in the number of personal computer users. To prevent any computer system breakdowns, we have taken numerous measures, including the duplication of various systems and infrastructures, constant maintenance of our computer system to ensure steady, uninterrupted operation, and the establishment of a disaster-prevention system consisting of computer centers in eastern and western Japan. And to maintain the confidentiality of customer information and prevent information leaks, sensitive information is encrypted, unauthorized external access is blocked, and all known countermeasures to secure data are implemented. There are also contingency plans and training sessions held as necessary to ensure full preparedness in the event of an emergency. To maintain security, countermeasures are revised as new technologies and usage patterns emerge.

Settlement Risk

Settlement risk is the possibility of a loss arising from a transaction that cannot be settled as planned. Because this risk comprises elements of several types of risk, including credit, liquidity, processing, and systems risk, it requires interdisciplinary management. At SMBC, the Operations Planning Department is responsible for coordinating the management of settlement risk with the Credit & Investment Planning Department, which oversees credit risk, and the Corporate Risk Management Department, which oversees liquidity risk.