

Risk Management

Basic Approach

As risks in the financial services increase in diversity and complexity, risk management—identifying, measuring, and controlling risk—has 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; and 3) Monitor the implementation of risk management by all Group companies to ensure that their practices meet the relevant standards.

(1) Types of Risk to Be Managed

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 system 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

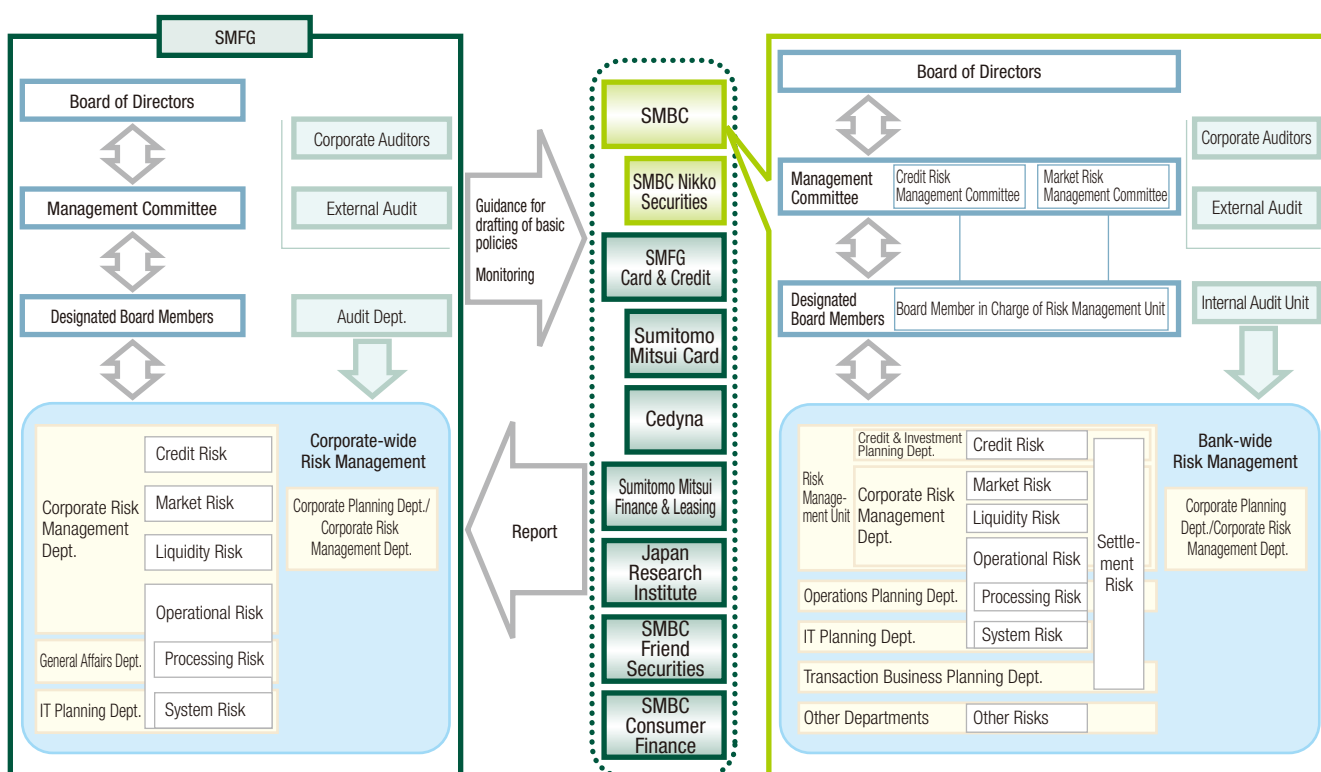
Risk Management Department works with the Corporate Planning Department to comprehensively and systematically manage all these categories of risk across the entire Group.

(2) Fundamental Principles and Basic Policies for Risk Management

SMFG's Groupwide basic policies for risk management stipulate the fundamental principles for risk management 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.

SMFG's Risk Management System



Risk Management System

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 Risk Management Unit has been established—independent of the business units—and the risk management framework has been strengthened by consolidating the functions for managing major risks—credit, market, liquidity and operational—into the Risk Management Unit and enhancing our across-the-board risk monitoring ability. A board member is assigned to oversee the Risk Management Unit comprising the Corporate Risk Management Department and Credit & Investment Planning Department. The Corporate Risk Management Department—the unit's planning department—comprehensively and systematically manages all categories of risk in cooperation with the Corporate Planning Department. Moreover, the Internal Audit Unit—independent of all business units—conducts periodic audits

to ensure that the management system is functioning properly.

Furthermore, under our system top management plays an active role in the approval of basic policies for risk management. The decision-making process for addressing credit, market, and liquidity risk 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.

Integrated Risk Management

(1) Risk Capital-Based Management

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. We measure "risk capital" based on value at risk (VaR), etc. as a uniform basic measure of credit, market, and operational risk, taking account of the special characteristics of each type of risk and the business activities of each Group company. We then allocate capital appropriately and effectively to each unit to keep total exposure to various risks within the scope of our resources, i.e., capital.

In the case of credit and market risk, we set maximum risk capital limits, which indicate the maximum risk that may be taken during the period, taking account the level of stress stipulated in business plans. In addition, for operational risk, we also allocate risk capital, and, for the Group as a whole, we set total risk capital allocations within SMFG's capital. Risk capital limits are subdivided

■ Risk Management Framework

Framework	Risk Category	
Risk Capital-Based Management	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.
	Market Risk	Banking Risk/Trading Risk
		Strategic Equity Investment Risk
		Other Market-Related Risks
	Operational Risk	Operational risk is the possibility of losses arising from inadequate or failed internal processes, people, and systems or from external events.
		Processing Risk
		System Risk
ALM/ Funding Gap	Liquidity Risk	Liquidity risk is the risk that there may be difficulties in raising funds needed for settlements, as a result of the mismatching of uses of funds and sources of funds or unexpected outflows of funds, which may make it necessary to raise funds at higher rates than normal levels.
Management by Risk Type	Other Risks (Settlement Risk and Others)	—

into guidelines or ceilings for each business including VaR and loss limits. Therefore, by strictly observing the VaR and loss limits, and other factors, SMFG maintains the soundness of the Group as a whole.

In this framework, risk capital includes credit concentration risk and interest rate risk in the banking book which are taken into account under the Second Pillar of Basel II. In addition, we conduct risk capital-based management activities on a consolidated basis, including each Group company.

Liquidity risk is managed within the context of cash-flow plans and funding gap. Other risk categories are managed with procedures closely attuned to the nature of the risk, as described in the following paragraphs.

(2) Stress Testing

In the current volatile business environment, stress testing to analyze and estimate the adverse effects of events such as an economic recession and market volatility on the business and financial conditions of financial institutions is increasingly essential. When establishing a management plan, SMFG also conducts stress tests using a number of stress events to analyze and estimate their impact on its financial condition.

Implementation of Basel Regulations

Basel II is an international agreement on the minimum capital requirements for internationally active banks, and it has been applied since March 31, 2007, to the internationally active banks in Japan.

Under the Basel II framework, there are multiple approaches to calculating the capital requirements. We have adopted the advanced internal ratings-based (IRB) approach for credit risk and the Advanced Measurement Approach (AMA) for operational risk since March 31, 2009 and March 31, 2008 respectively.

These Basel II regulations, as a measure to respond to the financial crisis at that time, were issued in July 2009 for the purpose of enhancing the framework mainly through the review of how to handle securitized products and trading accounts (Basel 2.5). In Japan the application of the regulations started at the end of December 2011.

Basel III was also issued in December 2010 as a new framework of capital requirements including the enhancement of international regulatory standards on bank capital adequacy and introduction of regulatory standards on liquidity. SMFG will take appropriate measures for the phase-in of this new framework from the end of March 2013.

Details of our 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 and Corporate Data.

Credit Risk

1. Basic Approach to Credit Risk Management

(1) Definition of 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.

(2) Fundamental Principles for Credit Risk Management

All Group companies follow the fundamental principles 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 Groupwide assets, and to ensure returns commensurate with risk. This leads to a loan portfolio that achieves high returns on capital and assets.

(3) 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, SMBC aims to enhance shareholder value and play a key part in society by providing high-value-added financial services.

2. Credit Risk Management System

At SMBC, the Credit & Investment Planning Department within the Risk Management Unit is 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 manages non-performing loans (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 Credit Portfolio Management Department within the Credit & Investment Planning Department has been strengthening its active portfolio management function for stable credit portfolios mainly through

credit derivatives and the sales of loans.

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 Servicer 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 along with branches, 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 Internal Audit Unit, operating independently of the business units, audits asset quality, accuracy of gradings and 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.

3. Credit Risk Management Methods

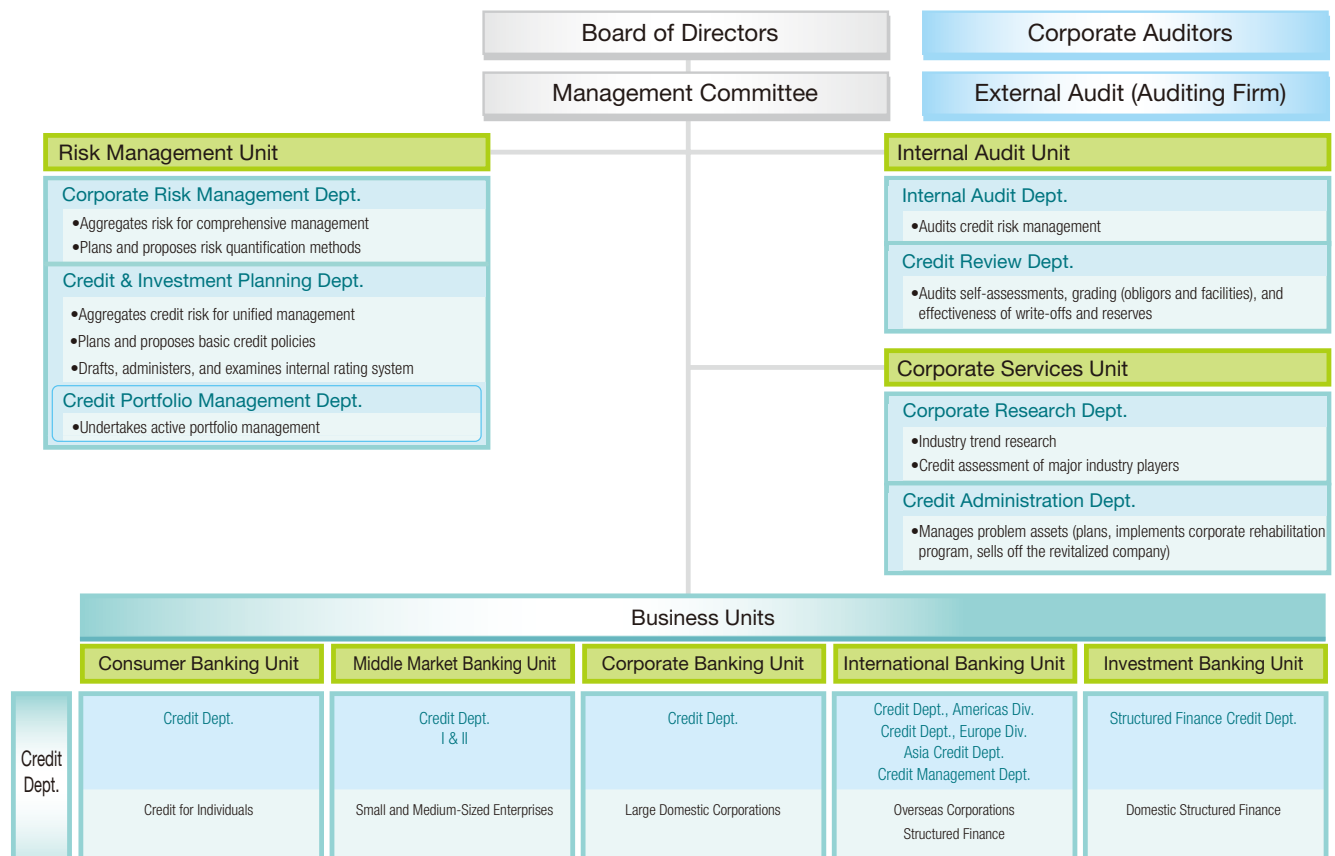
(1) Credit Risk Assessment and Quantification

At SMBC, 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 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 collectibility of assets taking into account transaction conditions such as guarantee/collateral, and tenor. An obligor grade

■ SMBC's Credit Risk Management System



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 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. 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.

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 small and medium-sized enterprises (SME) 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.

■ SMBC's Obligor Grading System

Obligor Grade		Definition	Borrower Category
Domestic (C&I), etc.	Overseas (C&I), etc.		
J1	G1	Very high certainty of debt repayment	Normal Borrowers
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 cases 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 mid to long term and the situation could change in cases 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	(Of which Substandard Borrowers)	Substandard Borrowers
J8	G8	Currently not bankrupt, but experiencing business difficulties, making insufficient progress in restructuring, and highly likely to go bankrupt	Potentially Bankrupt Borrowers
J9	G9	Though not yet legally or formally bankrupt, has serious business difficulties and rehabilitation is unlikely; thus, effectively bankrupt	Effectively Bankrupt Borrowers
J10	G10	Legally or formally bankrupt	Bankrupt Borrowers

(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.

(2) Framework for Managing Individual Loans

(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.

SMBC is also making steady progress in rationalizing its credit assessment process. 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

Financial Reconstruction Law Based Disclosure Category (Domestic)
Normal Assets
Substandard Loans
Doubtful Assets
Bankrupt and Quasi-Bankrupt Assets

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. The process is also used to 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 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 applies the following basic policies to the management of the entire credit portfolio to maintain and improve its soundness and profitability over the mid to long term.

(a) 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, such as for 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.

(b) Controlling Concentration Risk

Because the concentration of credit risk in an industry or corporate group has the potential to substantially impair capital, SMBC implements measures to prevent the 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.

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

Against a backdrop of drastic change in the business environment, SMBC rigorously researches borrower companies' actual conditions. It runs credit operations on the basic principle of earning returns that are commensurate with the credit risk involved, and makes every effort to reduce credit and capital costs as well as general and administrative expenses.

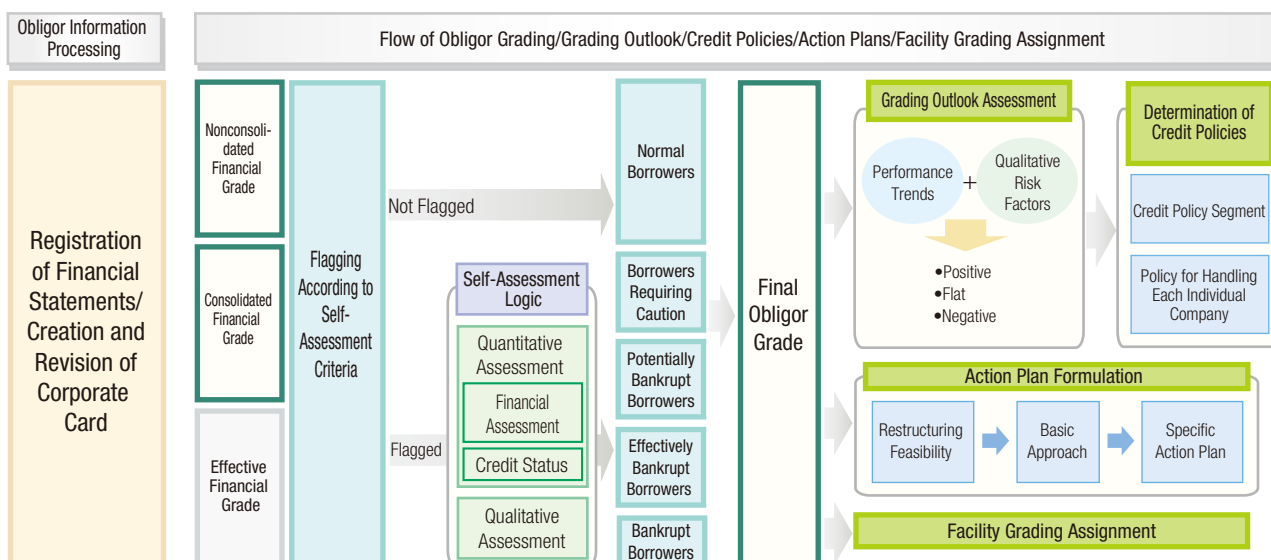
(d) Prevention and Reduction of Non-Performing Loans

On 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.

(e) Toward Active Portfolio Management

SMBC makes active use of credit derivatives, loan asset sales, and

■ SMBC's Credit Monitoring System



other instruments to proactively and flexibly manage its portfolio to stabilize credit risk.

(4) Self-Assessment, Asset Write-Offs and Provisions, and Disclosure of Problem Assets

(a) Self-Assessment

SMBC conducts rigorous self-assessment of asset quality using criteria based on the *Financial Inspection Manual* of the Financial Services Agency and the *Practical Guideline* published by the Japanese Institute of Certified Public Accountants. 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.

At the same time, self-assessment is a preparatory task for ensuring SMBC'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, Effectively 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. As part of our efforts to bolster risk management throughout the Group, our consolidated subsidiaries carry out self-assessment in substantially the same manner.

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
Effectively 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	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) Asset Write-Offs and Provisions

In cases where 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.

SMBC's write-off and provision criteria for each self-assessment borrower category are shown in the table below. As part of our overall measures to strengthen risk management throughout the Group, all consolidated subsidiaries use substantially the same standards as SMBC for write-offs and provisions.

Self-Assessment Borrower Categories		Standards for Write-Offs and Provisions
Normal Borrowers		The expected loss amount for the next 12 months is calculated for each grade based on the grade's historical bankruptcy rate, and the total amount is recorded as "provision for the general reserve for possible loan losses."
Borrowers Requiring Caution		These assets are divided into groups according to the level of default risk. Amounts are recorded as provisions for the general reserve in proportion to the expected losses based on the historical bankruptcy rate of each group. The groups are "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. 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.
Potentially Bankrupt Borrowers		A provision for the specific reserve for possible loan losses is made for the portion of Classification III assets (calculated for each borrower) not secured by collateral, guarantee, or other means. Further, when cash flows can be estimated reasonably accurately, the DCF method is applied mainly to large claims for calculating the provision amount.
Effectively Bankrupt/ Bankrupt Borrowers		Classification III asset and Classification IV asset amounts for each borrower are calculated, and the full amount of Classification IV assets (deemed to be uncollectible or of no value) is written off in principle and provision for the specific reserve is made for the full amount of Classification III assets.
Notes	General reserve	Provisions made in accordance with general inherent default risk of loans, unrelated to specific individual loans or other claims
	Specific reserve	Provisions made for claims that have been found uncollectible in part or in total (individually evaluated claims)

Discounted Cash Flow Method

SMBC uses the discounted cash flow (DCF) method to calculate the provision amounts for large claims on Substandard Borrowers and Potentially Bankrupt Borrowers 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.

(c) Disclosure of Problem Assets

Problem assets are loans and other claims of which recovery of

either principal or interest appears doubtful, and are disclosed in accordance with the Banking Act (in which they are referred to as “risk-monitored loans”) and the Financial Reconstruction Law (where they are referred to as “problem assets”). Problem assets are classified based on the borrower categories assigned during self-assessment. For detailed information on results of self-assessments, asset write-offs and provisions, and disclosure of problem assets at March 31, 2012, please refer to page 167.

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 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 risk 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, stock prices, or other market prices will change the market value of financial products, leading to a loss.

Liquidity risk is the risk that there may be difficulties in raising funds needed for settlements, as a result of the mismatching of uses of funds and sources of funds or unexpected outflows of funds, which may make it necessary to raise funds at higher rates than normal levels.

(2) Fundamental Principles for Market and Liquidity Risk Management

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.

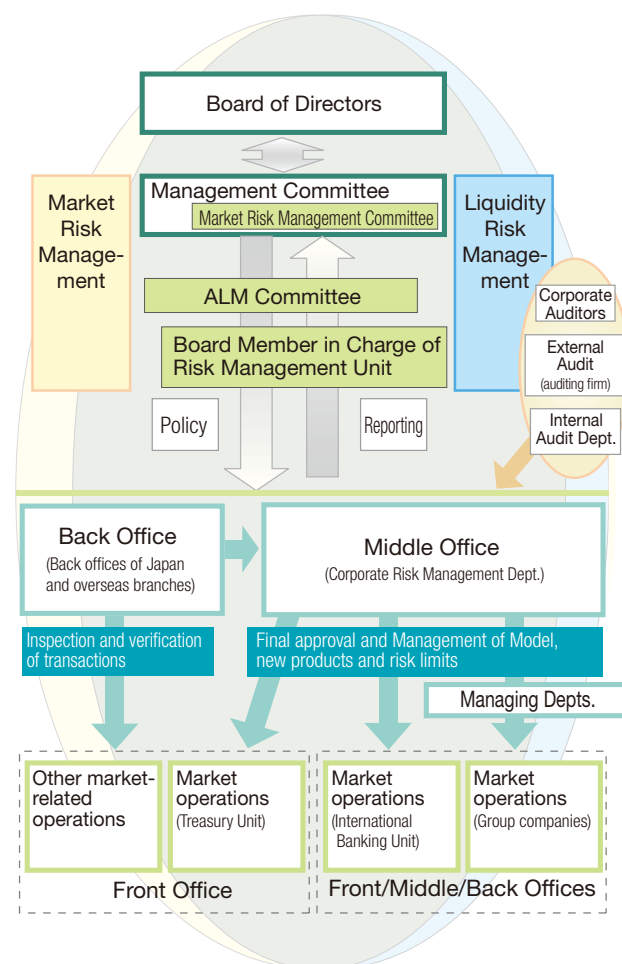
2. Market and Liquidity Risk Management System

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, at SMBC, the Corporate Risk Management Department, which is the planning department of the Risk Management Unit, an independent of the business units that directly handle market transactions, manages market and liquidity risks in an integrated manner. The Corporate Risk Management 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 to examine reports on the state of observance of SMBC’s limits on market and liquidity risks, and to review and discuss the SMBC’s ALM operation.

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, the Internal Audit Unit of SMBC periodically performs comprehensive internal audits to verify that the risk management framework is functioning properly.

■ SMBC’s Market Risk and Liquidity Risk Management System



3. Market and Liquidity Risk Management Methods

(1) Market Risk Management

SMBC manages market risk by setting maximum limits for VaR and maximum loss. These limits are set within the “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.

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

Please note that, in the case of interest rate fluctuation risk, the methods for recognizing the dates for maturity 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 differ substantially. At SMBC, the maturity of demand deposits that are expected to be left with the bank for a prolonged period is regarded to be five years (2.5 years on average). The cancellation prior to maturity of time deposits and consumer loans is estimated based on historical data.

(a) VaR Results

The results of VaR calculations for fiscal 2011 are shown in the table below. SMBC’s internal VaR model makes use of historical data to prepare scenarios for market fluctuations and, by conducting simulations of gains and losses, the model estimates the maximum losses that may occur (this is known as the historical simulation method). This internal SMBC model is evaluated periodically by an independent auditing firm to assess its appropriateness and accuracy.

(b) Back-Testing Results

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 2011 are shown at the top of the next page. A data point below the diagonal line indicates a loss in excess of the predicted VaR for that day; however, as in fiscal 2010, there were no such excess losses during fiscal 2011. This demonstrates that the SMBC VaR model, with a one-sided confidence interval of 99.0%, is sufficiently reliable.

(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). The bank conducts stress tests on a monthly basis assuming various scenarios, and has measures in place for irregular events.

Glossary

1. VaR (Value at risk)

The largest predicted loss that is possible given a fixed confidence interval. For example, VaR indicates, for a holding period of one day and a confidence interval of 99.0%, the maximum loss that may occur as a result of market fluctuations in one day with a probability of 1%.

2. BPV (Basis point value)

The amount of change in assessed value as a result of a one basis point (0.01%) movement in interest rates.

3. Trading

A market operation for generating profit by taking advantage of short-term fluctuations in market values and differences in value among markets.

4. Banking

A market operation for generating profit through management of interest rates, terms, and other aspects of assets (loans, bonds, etc.) and liabilities (deposits, etc.).

■ VaR Results

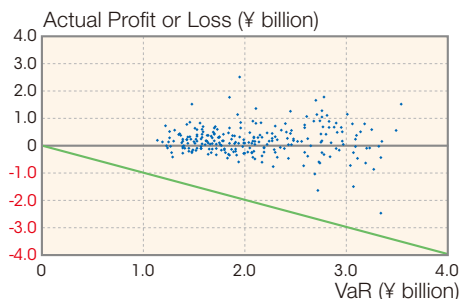
(Billions of yen)

	SMFG (consolidated)		SMBC (consolidated)		SMBC (nonconsolidated)	
	Trading Book	Banking Book	Trading Book	Banking Book	Trading Book	Banking Book
June 2011	9.0	40.4	8.3	39.4	2.1	35.8
Sept. 2011	9.0	38.8	8.5	38.0	1.3	34.5
Dec. 2011	9.5	36.3	8.9	35.5	3.2	31.4
Mar. 2012	10.0	32.0	9.3	31.3	1.2	27.8
Maximum	12.6	53.6	11.8	52.2	3.9	47.9
Minimum	5.9	31.8	5.4	31.0	1.2	27.6
Average	8.9	38.9	8.2	38.0	2.3	34.2

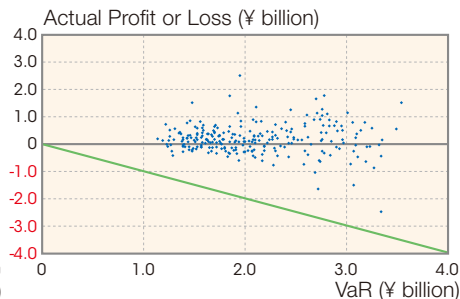
Note: VaR for a one-day holding period with a one-sided confidence interval of 99.0% [computed daily using the historical simulation method (based on four years of historical observations)].

■ Back-Testing Results (Trading Book)

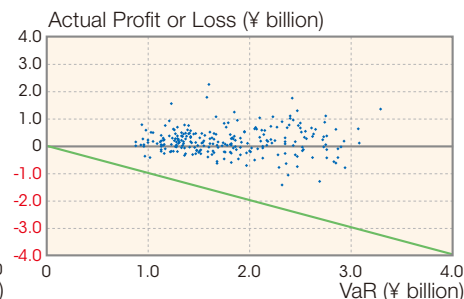
SMFG (consolidated)



SMBC (consolidated)



SMBC (nonconsolidated)



(d) Outlier Framework

In the event the economic value of a bank declines by more than 20% of the sum of Tier I and Tier II capital ("outlier ratio") as a result of interest rate shocks, the bank falls into the category of "outlier bank," as stipulated under the Second Pillar of Basel II.

As of March 31, 2012, the outlier ratio was around 3%, substantially below the 20% criterion.

(e) Managing Risk of Stocks Held for Strategic Purposes

The Corporate Risk Management Department establishes limits on allowable risk for strategic equity investments, and monitors the observance of those limits in order to control stock price fluctuation risk.

SMBC has been reducing its strategic equity investments and the outstanding amount is now significantly below the amount of Tier I capital, the maximum level permitted under the Act on Financial Institutions (etc.), Limits for Share, etc. Holdings.

(2) Liquidity Risk Management

At SMBC, liquidity risk is regarded as one of the major risks. SMBC's liquidity risk management is based on a framework consisting of setting funding gap limits and guidelines, maintaining highly liquid supplementary funding sources, and establishing contingency plans.

So as not to be overly dependent on short-term market-based funding to cover cash outflows, SMBC sets funding gap limits and guidelines. The funding gap limits and guidelines are set Bank-wide and for each region, taking into account cash management plans, external environment, funding status, characteristics of local currency and other factors. Additionally, a risk limit is set by currency as needed to achieve more rigorous management.

To minimize the impact of crises on the SMBC's funding, SMBC manages highly liquid supplementary funding sources, whereby SMBC maintains high quality liquid assets, such as U.S. treasuries and has emergency borrowing facilities.

In addition, for emergency situations, there are contingency plans in place for addressing funding liquidity risk that include an action plan with measures for reducing funding gap limits and guidelines.

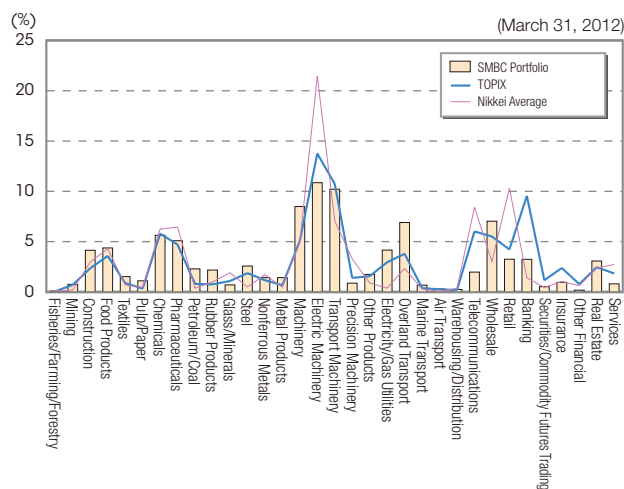
■ Decline in Economic Value Based on Outlier Framework

(Billions of yen)

	SMBC (consolidated)		SMBC (nonconsolidated)	
	March 31, 2011	March 31, 2012	March 31, 2011	March 31, 2012
Total	696.4	240.2	660.3	233.9
Impact of Yen interest rates	530.5	144.3	497.4	142.7
Impact of U.S. dollar interest rates	141.9	87.3	139.6	85.5
Impact of Euro interest rates	16.0	1.3	15.6	1.1
Percentage of Tier I + Tier II	7.8%	2.6%	7.7%	2.6%

Note: "Decline in economic value" is the decline of present value after interest rate shocks (1st and 99th percentile of observed interest rate changes using a 1-year holding period and 5 years of observations).

■ Composition, by Industry, of Listed Equity Portfolio



1. Basic Approach to Operational Risk Management

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Specifically, Basel II—which, in addition to processing risk and system risk, also covers legal risk, personnel risk, and physical asset risk—defines the following seven types of events that may lead to the risk of loss: (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.

SMFG and SMBC have set forth 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 and SMBC have been working to enhance the operational risk management framework across the whole Group by establishing an effective system for identification, assessment, controlling, and monitoring of material operational risks and a system for executing contingency and business continuity plans. Based on the framework of Basel II, SMFG has been continuously pursuing sophisticated quantification of operational risks and advanced Groupwide management.

SMFG has designed and implemented an operational risk management framework for Groupwide basic policies for risk management.

As the brief overview, this system operates by collecting and analyzing internal loss data occurred at each department or branch as well as comprehensively specifying scenarios involving operational risks based on the operational procedures of each branch on regular-basis and estimating the loss amount and frequency of the occurrence of such losses based on each scenario. Risk severities are quantified for each scenario and for those scenarios having high severities the risk mitigation plan will be developed by the relevant department and the status on the progress of such risk mitigation plan will be followed up by the Corporate Risk Management Department. Furthermore, operational risks are quantified, and quantitatively managed by utilizing the collected internal loss data and scenarios.

These occurrences of internal loss data, severity of scenarios

The diagram illustrates the Operational Risk Management Framework, showing the hierarchy and flow of information and direction.

External Oversight:

- Corporate Auditors
- External Audit (Auditing Firm)
- Internal Audit Dept.

Internal Governance:

- Board of Directors
- Management Committee
- Operational Risk Committee

Operational Risk Management Unit:

- Board Member in Charge of Risk Management Unit
 - Corporate Risk Management Dept.
 - Supervisor of overall operational risk management
 - Measurement of operational risk

Operational Risk Management Process:

- Generation of scenarios and development of risk mitigation actions
- Reflection of internal loss data, external loss data and BEICFs in scenarios
- Internal loss data

Head Office departments:

- Consumer Banking
- Middle Market Banking
- Corporate Banking
- Treasury
- Investment Banking
- International Banking

Flow of Information and Direction:

- Direction:** Board of Directors → Management Committee → Board Member in Charge of Risk Management Unit → Corporate Risk Management Dept.
- Reporting:** Internal Audit Dept. → Board Member in Charge of Risk Management Unit; Corporate Risk Management Dept. → Board Member in Charge of Risk Management Unit; Head Office departments → Corporate Risk Management Dept.; Internal loss data → Corporate Risk Management Dept.
- Operational Risk Committee:** Provides feedback of measurement results related to operational risk and monitoring of progress in risk mitigation plans.

and status on risk mitigation are regularly reported to the director in charge of the Corporate Risk Management Department. In addition, there is the Operational Risk Committee, comprising all relevant units of the bank, where operational risk information is reported and risk mitigation plans are discussed. In this way, we realize 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. Moreover, the bank's independent Internal Audit Department conducts periodic audits to ensure that the operational risk management system is functioning properly.

3. Operational Risk Management Methodology

As previously defined, operational risks cover a wide-range of cases, including the risks of losses due to errors in operation, system failures, and natural disasters. Also, operational risk events can occur virtually anywhere and everywhere. Thus, it is essential to check whether material operational risks have been overlooked, monitor the overall status of risks, and manage/control them. To this end, it is necessary to be able to quantify risks using a measurement methodology that can be applied to all types of operational risks, and to comprehensively and comparatively capture the status of and changes in potential operational risks of business processes. Also, from the viewpoint of internal control, the measurement methodology used to create a risk mitigation plan must be such that the implementation of the plan quantitatively reduces operational risks.

SMFG and SMBC adopted, at the end of March 2008, the Advanced Measurement Approach (AMA) set forth by Basel II for calculating capital requirements for operational risks and the AMA has been utilized for the management of operational risks since then.

The basic framework for quantifying operational risks consists of internal loss data, external loss data, Business Environment and Internal Control Factors (BEICFs) and scenario analysis. Out of the above-mentioned four factors, internal loss data and the results of scenario analysis (hereinafter, the "assumption data") are input into the internal measurement system (hereinafter, the "quantification model") developed by SMBC; and capital requirements for operational risks and risk asset (capital requirements for operational risks is divided by 8%) is calculated. In addition, external loss data and BEICFs along with internal loss data are used for verifying the assessment of scenarios to increase objectivity, accuracy and completeness.

SMFG, including the Group companies to which the AMA is applied, collect the four elements. This is outlined as follows.

(1) Internal Loss Data

Internal loss data are defined as "the information for events which SMFG incur losses due to operational risks."

(2) External Loss Data

External loss data are defined as "the information for events which other banks, etc. incur losses due to operational risks."

(3) Business Environment and Internal Control Factors (BEICFs)

BEICFs are defined as "factors affecting operational risks which are associated with conditions of business environment and internal control of SMFG."

(4) Scenario Analysis

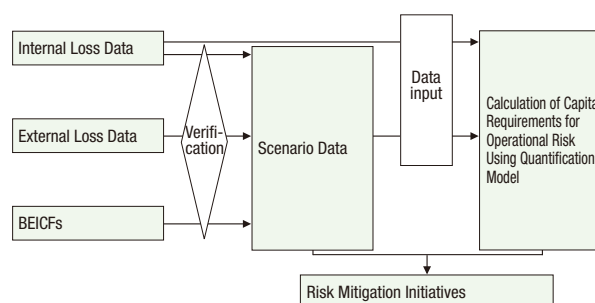
Scenario analysis is defined as a "methodology which identifies assumed cases involving any material operational risks and describe them in terms of risk scenario, and estimate the frequency and severity of risk scenarios." SMFG's principal business operations are applicable for this methodology.

The purposes of scenario analysis are to identify any potential risks underlying in our business operations; to measure risks based on the possibility of occurrence of the said potential risks; and to review and execute any required measures. Furthermore, another purpose of the scenario analysis is to estimate the frequency of low-frequency and high-severity events for each scenario (which may be difficult to estimate using internal loss data alone).

(5) Measurement Using the Quantification Model

The quantification model produces the distribution of loss frequency and loss severity based on the internal loss data and scenario data; and it also produces the loss distribution based on the said distribution of loss frequency (distribution of losses in a year) and the distribution of loss severity (distribution of loss amount per case) by making scenarios of the various combination of frequencies and amount of losses according to the Monte Carlo simulations; and it calculates the maximum amount of loss expected, due to operational risks, based on the assumption of one-sided confidence interval of 99.9% and the holding period of one year. The measurement units are SMFG consolidated basis, SMBC consolidated basis and SMBC non-consolidated basis; and it is measured according to each of seven event types set forth by Basel II and the capital

Basic Framework of Operational Risk Measurement



requirements for operational risks are calculated based on AMA by simply consolidating the amounts of all event types.

The measurement accuracy is ensured by implementing the regularly conducted verifications of the said quantification model at pre- and post-occurrences.

Meanwhile, as for the capital requirements for operational risks of other Group companies not applicable for AMA and in preparation to become applicable for AMA, it is calculated according to the Basic Indicator Approach (BIA), and the capital requirements for operational risks for SMFG consolidated basis and SMBC consolidated basis are calculated by consolidating such amount calculated based on BIA with the capital requirements for operational risks calculated based on AMA.

(6) Risk Mitigation Initiatives

To mitigate risks using the quantitative results of the AMA, SMFG and SMBC implement risk mitigation measures for high severity scenarios. Furthermore, the risk assets calculated by quantification are allocated to each business unit of SMBC and other Group companies for increasing awareness of operational risks internally in the Group companies, improving the effectiveness of their operational risk management and mitigating operational risks of the entire Group.

4. Processing Risk Management

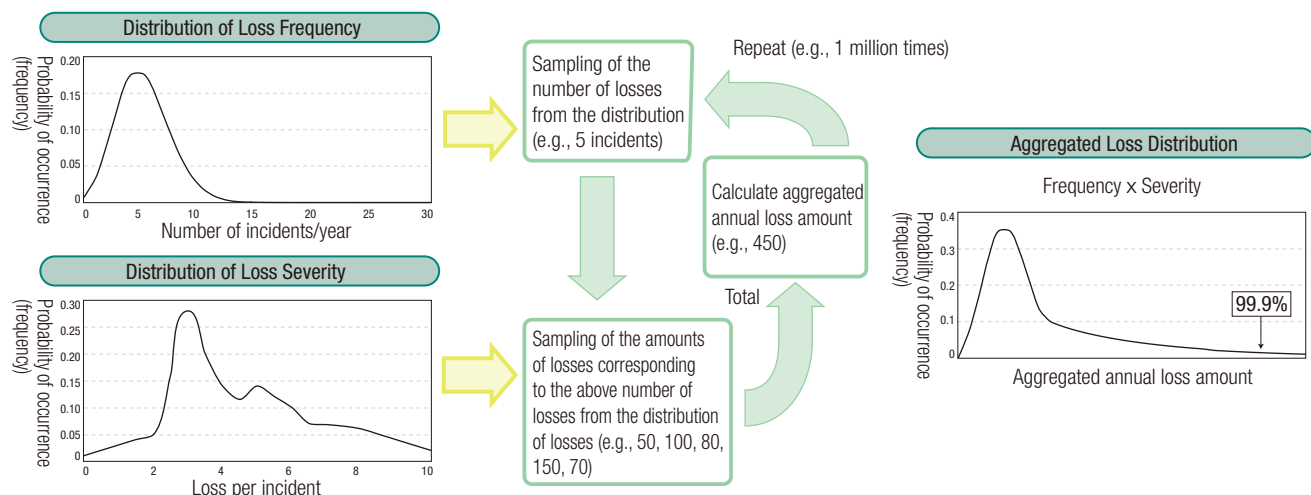
Processing risk is the possibility of losses arising from negligent processing by employees, accidents, or unauthorized activities.

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.

■ Measurement Using the Quantification Model



5. System Risk Management

System 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 system 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 system 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 great potential to impact society, with system risk diversifying owing to advances in IT and expansion of business fields. To prevent any computer system breakdowns, we have taken numerous measures, including constant maintenance of our computer system to ensure steady and uninterrupted operation, duplication of various systems and infrastructures, 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 system risk, it requires interdisciplinary management.

At SMBC, the Transaction Business Planning Department acts as coordinator and works together with the Credit & Investment Planning Department responsible for credit risk, the Corporate Risk Management Department responsible for liquidity risk, and the Operations Planning Department responsible for processing risk to improve risk management.