Risk Management

Our basic position

Major change in the business environment for financial institutions, including economic, financial, and regulatory conditions, has increased the importance of promoting appropriate risk-taking practices at a diversified financial services company like SMFG as we have developed our businesses and pursue our management and financial targets. We need to be accurate in our perception of the business environment and risk and rigorous in our risk analysis and management.

Business and risk view is shared across the SMFG Group, and we have an overarching Risk Appetite Framework (RAF) for systematic management of risk. RAF guides us in conducting business by clarifying the type and amount of risk we should take to expand earnings.

SMFG's Risk Appetite Framework

Within the SMFG Group's overall exercise of risk controls, we seek to secure appropriate risk / return by clarifying the types and levels of risk that we are willing to take on or prepared to tolerate for profit growth (risk appetite).

Risk Appetite Framework (RAF) plays a key role in SMFG's realization of sustainable growth, and we position RAF and business strategy as the two pivots of our business management.

Our basic position and risk appetite specifics are set out in an internal document for group-wide use.

Risk appetite

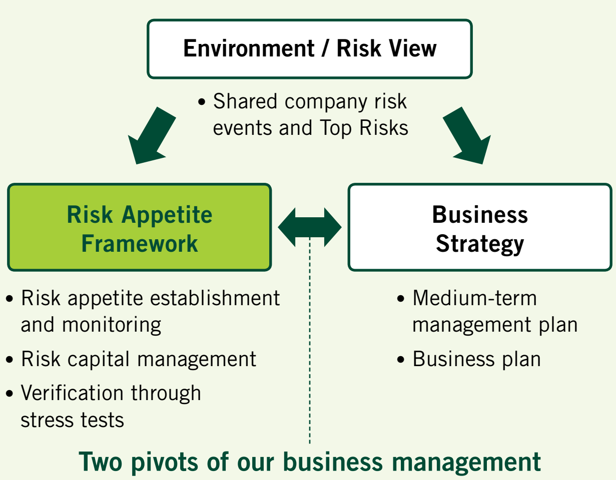
At SMFG, we have a Risk Appetite Statement that provides a qualitative explanation of our approach to risk taking and risk management for such categories as soundness, profitability, and liquidity. We also have quantitative Risk Appetite Measures that function as benchmarks for risks that we are considering taking and for risk / return.

As an illustration, for the soundness category, our Risk Appetite Statement has "maintain a sufficient level of capital to support sustainable growth" as the overall policy. It also includes specific policies for the fiscal year in question based on our view of the environment and risk. The Risk Appetite Measures are numerous and include the common equity Tier 1 (CET1) ratio.

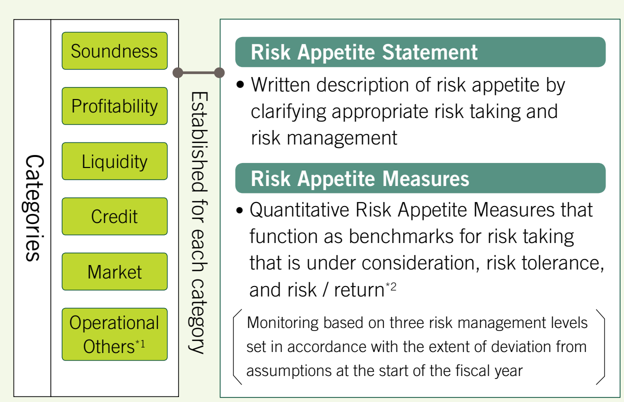
Operation of Risk Appetite Framework

The process of setting risk appetite for each fiscal year begins with discussions on the current and future business environment and risks by the Management Committee and the Board of Directors. Based on their shared view of risks, they select Top Risks, that is to say the risks that may have a material impact on SMFG. Risk appetite is then decided on the basis of stress test results and other risk analysis that illustrates impact if risks should be realized. Business strategy and policies for the conduct of business are drawn up on the basis of the risk appetite decisions.

▶ Risk Appetite Framework Positioning



▶ Risk Appetite Composition



*1 Items related to compliance, processing risk, system risk, and others

*2 Separately, measures are established for use in predicting change in Risk Appetite Measures and understanding the current risk situation. Monitoring is conducted based on these measures.

Views of the environment and risks, including Top Risks, are continuously updated in the course of the fiscal year's business and the risk appetite situation is monitored regularly through the medium of Risk Appetite Measures and other controls. The results are reported to the Management Committee and the Board of Directors.

If risk appetite monitoring reveals notable deviation from the measures set at the start of the fiscal year, consideration is given to revising risk appetite and business strategy as required.

Comprehensive risk management

Risk is managed systematically at SMFG. Thorough assessments of the environment and risk, including Top Risks, are carried out to ensure effective operation of RAF, and there is a framework for risk analysis (stress tests) and risk capital management.

Our basic position

At SMFG, we classify group-wide risk into credit risk, market risk, liquidity risk, and operational risk, and we manage each risk according to its particular characteristics.

Holding company SMFG provides guidance to Group companies in identifying categories of risk they need to address for their particular businesses. These risk categories are continuously reviewed and new risks are added when they arise due to changes in the operating environment.

Top Risks

We select the risks that may have a material impact on business management, mainly from the potential risks for the next 12 months, and label these Top Risks. The selection of Top Risks involves a wide-range screening for candidates, an evaluation of each risk's potential impact and probability of occurrence, and full discussion by the Risk Committee (see page 57), the Management Committee, and the Board of Directors.

Environment and risk views are shared across the Group by means of this process, and we seek to refine our risk management by continually checking on the status of our responses to each Top Risk.

Cyber risk is one of our selections for Top Risk. Based on the growing sophistication and variety of cyber-attacks and the scale of their social impact in case they cause information systems to crash, we have made reinforcement for attacks a top management priority.

Risk Management Categories

Risk Management Framework	Categories	
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	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. (Categories include banking risk, trading risk, and strategic equity investment risk.)
	Operational Risk	Operational risk is the possibility of losses arising from inadequate or failed internal processes, people, and systems or from external events. (Categories include processing risk and system risk.)
ALM / Funding Gap	Liquidity Risk	Liquidity risk is defined as uncertainty around the ability of the firm to meet debt obligations without incurring unacceptably large losses. Examples of such risk include the possible inability to meet current and future cash flow / collateral needs, both expected and unexpected. In such cases, the firm may be required to raise funds at less than favorable rates or be unable to raise sufficient funds for settlement.
Management by Risk Type	Other Risks (Settlement Risk and Others)	—

Stress testing

Financial institutions' business environment is constantly changing and can sometimes impact heavily on operations. At SMFG, we use stress testing for forward-looking risk management, seeking to analyze and comprehend the effect on SMFG's soundness if such risks as recession or market turbulence should materialize.

In our stress tests, we use the previously explained Top Risks as well as multiple scenarios produced in discussions with experts and related business units and departments.

For business strategy, we use stress tests to assess risk-taking capabilities at SMFG and verify the appropriateness of strategies based on whether adequate soundness can be maintained under stress.

Risk capital management

In managing the risk categories shared by the SMFG Group as a whole, we apply a uniform standard, risk capital[*1] based on VaR (value at risk)[*2]. This measurement is applied to credit, market, and operational risk, taking account of each risk's particular characteristics and individual Group company business characteristics, and used to set upper limits within the scope of our resources (capital). Risk capital is also used in optimizing capital allocation on a Group consolidated basis.

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

*2 VaR: The maximum loss expectation for a portfolio of financial assets for a given probability.

Stress Testing Process

(1) Scenario design

Scenarios are designed based on the Corporate Risk Management Department's summation of Top Risks discussed by the Risk Committee, the Management Committee, and the Board of Directors and the views of related departments on such factors as future global trends.

Trend scenario (economic forecast) → **Downside scenario** (within the bounds of possibility) → **Stress scenario** (once in 10 years) → **Severe stress scenario** (once in 25 years)

(2) Scenario finalization

Scenarios are revised as necessary based on the outcome of discussions between specialists and related departments.

(3) Calculation of impact

The scenario's impact on each financial item is estimated and aggregated for analysis of the impact on such factors as the common equity Tier 1 ratio.

(4) Confirmation by the Management Committee and the Board of Directors

The impact on the common equity Tier 1 ratio etc., (3), from the scenario set in (2) is reported to the Management Committee and the Board of Directors for verification of the appropriateness of business strategy.

SMFG's risk management system

Risk management system

Reflecting the importance of risk management, top management plays an active role in the process. The group-wide basic policies for risk management are determined by the Management Committee before being authorized by the Board of Directors.

In line with SMFG's group-wide basic policies for risk management, the functions for managing major risks are consolidated at the Corporate Risk Management Department, and we seek to refine our risk management system by such means as cross-the-board reviews for each risk category. In addition, the Internal Audit Unit audits risk management to verify whether the system is working properly.

Risk management systems are in place at the individual Group companies for their particular businesses in accordance with the basic policies. At SMBC, for example, specific departments have been appointed for risks associated with settlement in addition to the overall handling of such categories as credit and market risk. Each risk category is managed in accordance with its particular characteristics.

Risk Committee

The Risk Committee is an internal committee of the Board of Directors, composed of outside directors as well as inside and outside experts.

The Risk Committee meets regularly to discuss a wide range of risk management and compliance topics, including Top Risks and RAF, from a specialist viewpoint. The results are reported to the Management Committee and the Board of Directors for reflection in SMFG Group operations.

SMFG's Risk Management System