



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 established the basic principles of group-wide risk management in the “Policies on Comprehensive Risk Management.” In the policies, we identify the location and the type of risk to be managed in accordance with strategic goals and business structures. We have set forth the fundamental principles for comprehensive risk management as shown in the Table below and manage each risk appropriately according to its characteristics. We share the principles internally to foster a sound risk culture.

In addition, SMFG has established the “Principal Policy on Group Risk Management” which sets forth the specific operational policies for appropriately conducting risk management in line with the basic principles across all companies. The Principal Policy is reviewed regularly and as necessary (see page 57).

■ Fundamental Principles on Comprehensive Risk Management (Excerpt major principles)

Basic Principles	Description
Risk management on a consolidated basis	Various risks taken at the SMFG and the Group companies to be managed on a consolidated basis according to the business and importance in conformity with the relevant laws and regulations.
Risk management based on quantification	The risks subject to control to be quantitatively managed according to the relevant risk characteristics after specifying the scope of quantification.
Ensuring consistency with the business strategy	Risk management to be consistent with the business strategy.
System for check and balance	The risk management framework to be developed to ensure effective check and balance function for business operations.
Measures for emergencies and critical situations	Necessary measures to be developed by assuming situations, scenarios etc. as to materialization of risk which would have a significant impact on the business and financial management of SMFG
Verification of the actual situation	The actual risk management process to be verified by the Internal Audit Unit.

Comprehensive Risk Management

Based on the Principal Policy, SMFG takes a comprehensive and systematic approach to risk management, with risk analysis by stress testing and risk capital management following ascertainment of environment and risk view, including top risks (see page 55).

Risk Management System

Reflecting the importance of risk management, top management plays an active role in the process. The “Principal Policy on Group Risk Management” is determined by the Management Committee before being authorized by the Board. In addition, the Board has a risk committee that meets regularly to review and discuss a wide range of topics related to risk management and compliance issues in the aim of continuously raising the level of risk governance at SMFG (see page 57).

Implementation of Basel Capital Accord

The Basel III regulatory framework consists of capital, leverage, and liquidity ratios designed to maintain sound operating standards for internationally active banks. SMFG calculates its ratios in accordance with the standards for Japanese banks. Risk assets subject to the Basel Capital Accord totaled ¥66,011.6 billion as of March 31, 2016, down ¥125.2 billion from March 31, 2015. The main factors behind the decrease in risk-weighted assets were a decrease in the balance of equity and fund investment (credit risk), a decrease in trading positions (market risk), and a revision in the methodology for risk quantification of tangible asset damages from earthquakes (operational risk).

Capital ratio and other regulations are currently under review by the Basel Committee on Banking Supervision (BCBS). SMFG plans to respond appropriately to revisions after conducting comprehensive impact analysis.

As of March 31, 2016, SMFG was designated a Global Systemically Important Bank (G-SIB) by the Financial Stability Board (FSB) and SMFG is subject to the phase in of the add-on to the minimum capital ratio requirement (for the current bucket, 1.0%).

■ Risk-Weighted Assets as of March 31, 2016

	March 31, 2015	March 31, 2016	Increase (decrease)
Credit risk	61.3	61.2	(0.1)
Market risk	2.0	1.5	(0.5)
Operational risk	2.8	3.3	+0.5
Total	66.1	66.0	(0.1)

(Trillions of yen)

■ Risk Assets at Individual Departments

		(Trillions of yen)
Sumitomo Mitsui Financial Group	Wholesale	15.9
	Credit risk	15.6
	Retail	7.2
	Credit risk	7.0
	International	18.1
	Credit risk	17.1
	Other	24.9
	Credit risk	21.5

Note: Other includes Treasury Unit, Investment Banking Unit and Group companies.

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 group-wide basis and further raise the level of accuracy and comprehensiveness of group-wide credit risk management. Each Group company must comprehensively manage credit risk according to the nature of its business, and assess and manage credit risk of individual loans and credit portfolios quantitatively 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 group-wide assets, and to ensure returns commensurate with risk. This leads to a loan portfolio that achieves high returns on capital and assets.

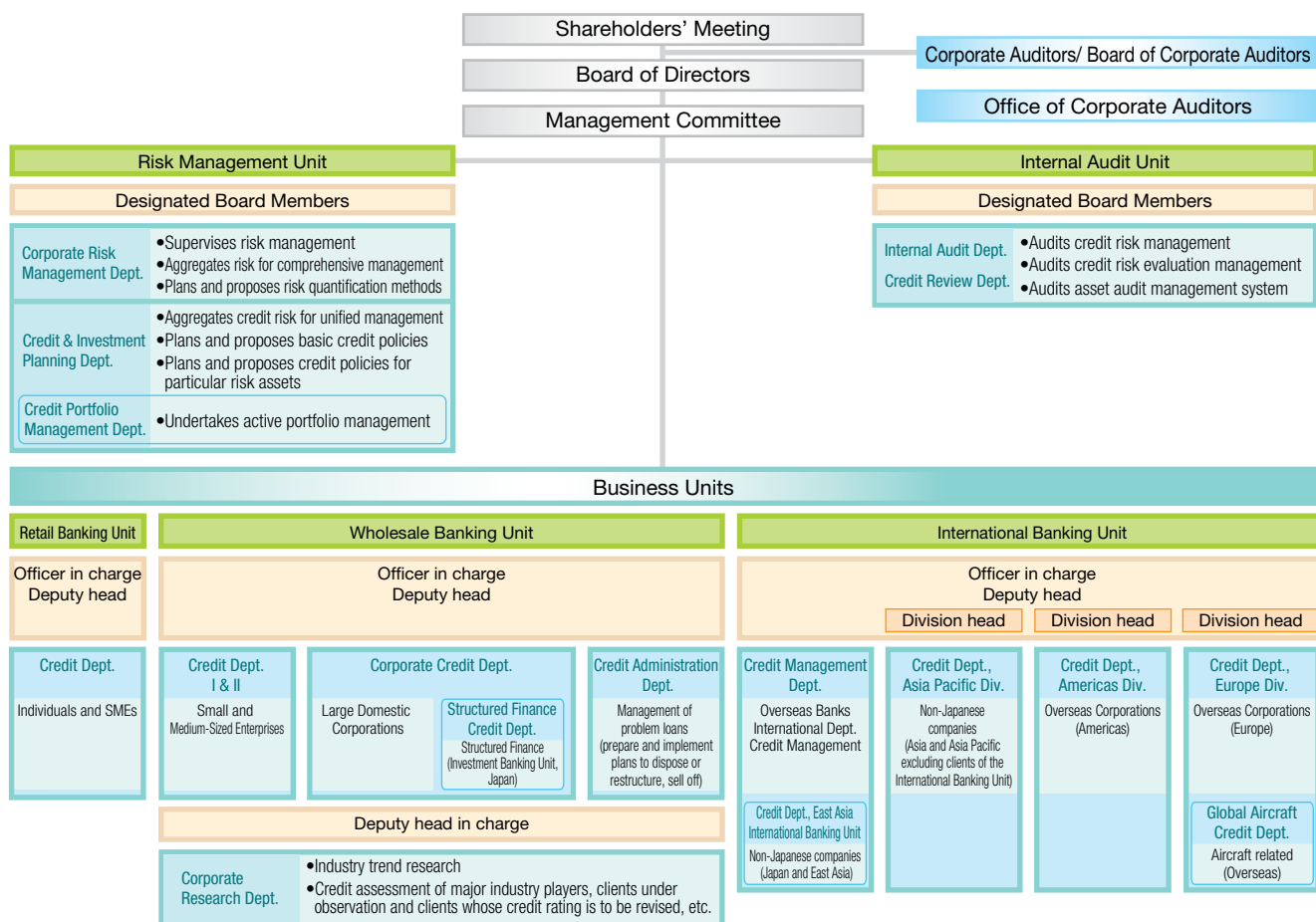
(3) Credit Policy

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

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,

■ SMBC's Credit Risk Management System



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 Credit Departments within each business unit conduct credit risk management, along with the branches, for loans handled by their units and manage their units' portfolios. The credit approval authority is determined based on the credit amount and internal grades, while credit departments focus on the analysis and management of customers and transactions with relatively high credit risk.

The Credit Administration Department is responsible for handling NPLs of borrowers classified as potentially bankrupt or lower, and draws up plans for their workouts, including write-offs. It works to efficiently reduce the amount of NPLs through Group company SMBC Servicer Co., Ltd., which engages in related services, and by such means as the sell-off of claims.

Through industrial and sector-specific surveys, and studies of individual companies, the Corporate Research Department works to form an accurate idea of the circumstances of borrower companies and quickly identify those with potentially troubled credit positions as well as promising growth companies.

The 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 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 loans to individuals, and project finance and other structured finance tailored according to the risk characteristics of these types of assets.

■ SMBC's Obligor Grading System

Obligor Grade		Definition	Borrower Category	Financial Reconstruction Act Based Disclosure Category (Domestic)
Domestic (C&I), etc.	Overseas (C&I), etc.			
J1	G1	Very high certainty 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 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	Substandard Loans
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	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 or formally bankrupt	Bankrupt Borrowers	

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.

(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.

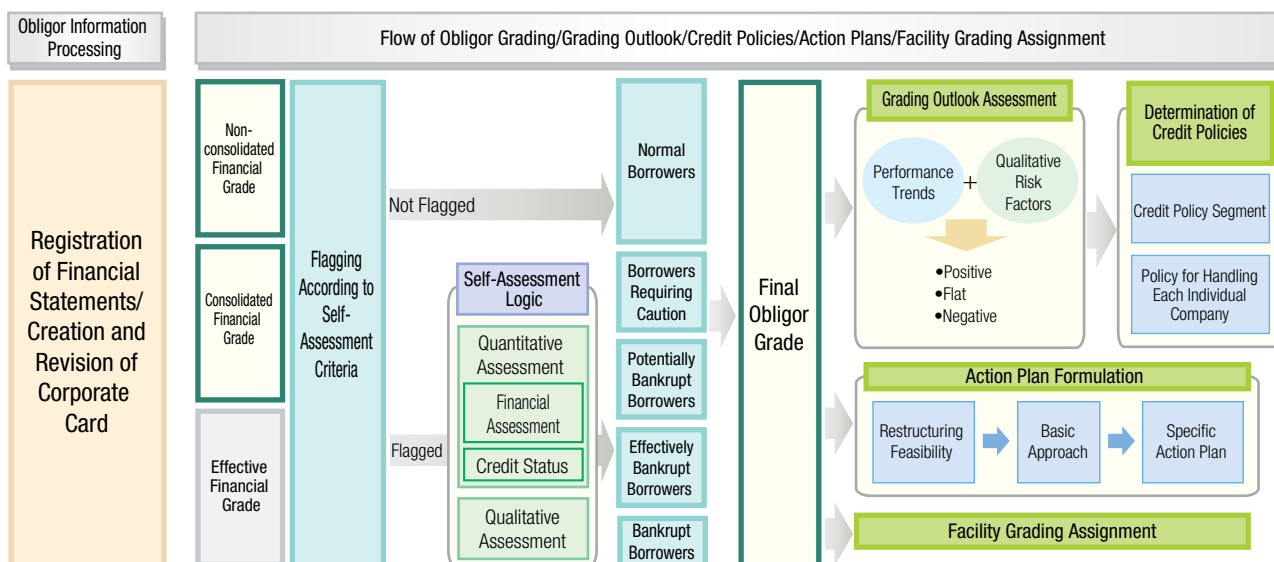
Increasing the understandability to customers of loan conditions and approval standards for specific borrowing purposes and loan categories is a part of SMBC's ongoing review of lending practices, which includes the revision of loan contract forms with the chief aim of clarifying lending conditions utilizing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

SMBC is also making steady progress in streamlining 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 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.

■ SMBC's Credit Monitoring System



(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 on page 82.

(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 a credit risk capital limit for internal control purposes. Under this limit, sub-limits are set for each business unit. Regular monitoring is conducted to make sure that these limits are being followed, thus ensuring appropriate overall management of credit risk.

(b) Controlling Concentration Risk

As the equity capital of the bank may be materially impaired in the event that the credit concentration risk becomes apparent, SMBC implements measures to manage credit towards an industrial sector with excessive risk concentration, introduces large exposure limit lines and conducts intensive loan review for obligors with large exposure.

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 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 next page. 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 Act (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, 2016, please refer to page 263.

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

(2) Fundamental Principles for Market and Liquidity Risk Management

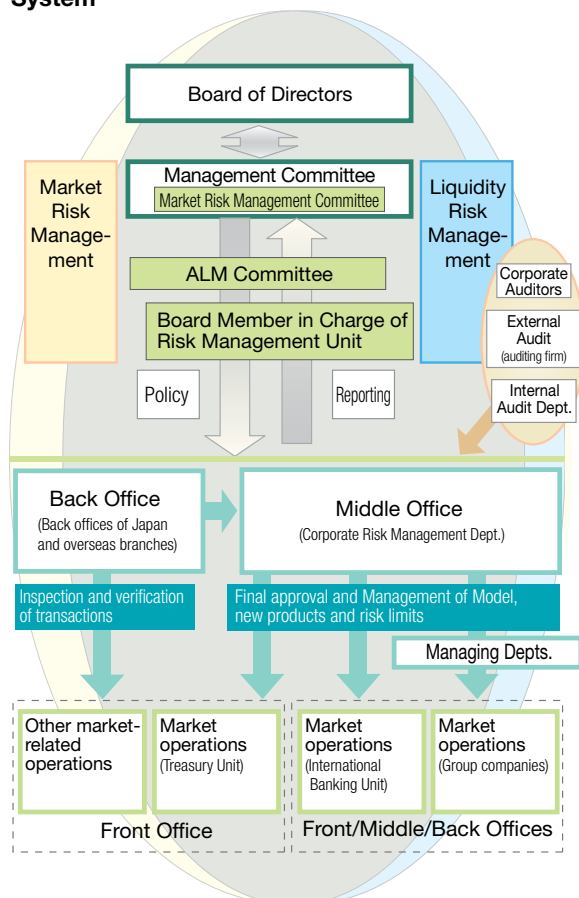
SMFG is working to further enhance the effectiveness of its quantitative management of market and liquidity risks across the entire Group by setting allowable risk limits; ensuring the transparency of the risk management process; clearly separating front-office, middle-office and back-office operations;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

2. Market and Liquidity Risk Management System

On the basis of SMFG's group-wide 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

■ SMBC's Market Risk and Liquidity Risk Management System



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.

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.

■ VaR for Trading Activities

(Billions of yen)

	fiscal 2015					March 31, 2015
	March 31, 2016	September 30, 2015	Maximum	Minimum	Average	
SMFG (consolidated)	11.0	15.6	22.5	9.6	14.2	14.5
Interest rates	8.1	13.0	16.5	7.0	10.6	7.2
Foreign exchange	1.1	1.1	3.7	0.3	1.4	1.3
Equities, commodities, etc.	2.5	2.3	7.9	1.6	3.2	6.9
SMBC (consolidated)	10.4	14.9	21.4	8.6	13.3	13.8
SMBC (non-consolidated)	1.3	1.8	6.2	0.8	2.4	1.7

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)].

(a) Market Risks

a. Trading activities

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

The table on the previous page shows the VaR results of the Group's trading activities during fiscal 2015. Because of the nature of trading, the VaR fluctuated sharply during fiscal 2015, in line with changes in our investment positions.

b. Banking activities

Banking activities are market operations which gain profits by controlling interest rates and term period for assets (loans, bonds, etc.) and liabilities (deposits, etc.). At SMFG, in the same way as in the case of trading activities, we assess and manage the market risk of banking activities on a daily basis, utilizing VaR and other tools.

The following table shows the VaR results of the Group's banking activities during fiscal 2015. The VaR of the Group decreased on March 31, 2016 compared with on March 31, 2015 primarily reflecting an decreased position in equities.

(b) Market Risk Volume Calculation Model

a. Presuppositions and limits of model

In SMBC's internal VaR model, various market fluctuation scenarios are drawn up on the basis of past data, and the historical simulation method is used to run profit-and-loss movement simulations that enable us to forecast probable maximum losses. The appropriateness of the model is later verified through back-testing.

However, as back-testing cannot take into account major market fluctuations that have not actually occurred historically, we supplement this method with the use of stress testing.

This internal model employed by SMBC undergoes regular auditing by an independent auditing firm to ensure that it operates appropriately.

b. Validity verification process

i Outline of validity verification

SMBC uses back-testing as a method for verification of the validity of the internal model. VaR figures calculated by the internal model are compared with actual portfolio profit-and-loss figures on a given day, to compute an appropriate VaR level and confirm the adequacy of risk capital management.

ii Back-testing results

The results of back-testing on SMBC's trading book conducted in fiscal 2015 are shown below. A data point under the diagonal line indicates a loss exceeding VaR for that day. Five such data points were observed and SMBC is accordingly making conservative amendments to VaR values.

■ VaR for Banking Activities

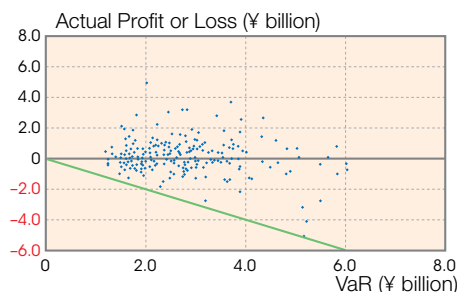
(Billions of yen)

	fiscal 2015					March 31, 2015
	March 31, 2016	September 30, 2015	Maximum	Minimum	Average	
SMFG (consolidated)	34.0	40.4	48.9	23.5	38.7	39.0
Interest rates	18.7	21.1	26.9	14.1	20.8	18.0
Equities, etc.	27.5	28.9	34.6	17.5	28.7	31.1
SMBC (consolidated)	33.6	39.5	48.0	23.1	37.8	37.8
SMBC (non-consolidated)	29.0	35.2	43.4	19.3	33.9	34.9

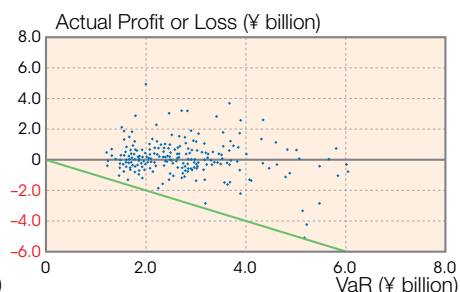
Notes: 1. VaR for a one-day holding period with a one-sided confidence interval of 99.0% [computed daily using the historical simulation method (based on four years of historical observations)].
2. The above category of "Equities" does not include stocks held for long-term strategic purposes.

■ Back-Testing Results (Trading Book)

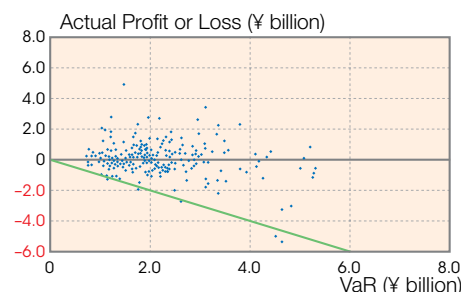
SMFG (consolidated)



SMBC (consolidated)



SMBC (non-consolidated)



iii Reasons for losses exceeding the VaR

In all cases, these were the result of significant fluctuations on the foreign exchange and interest rate and stock markets.

c. Indicators substitute for the back-testing method

SMFG employs, as a method substitute for the back-testing method, the VaR wherein presumption for the model such as observation period changes.

d. Changes in model from previous fiscal year

The model in use remains unchanged from that employed in the previous fiscal year.

(c) Stress Testing

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

(d) Outlier Framework

In the event the economic value of a bank declines by more than 20% of total capital as a result of interest rate shocks, that bank would fall into the category of "outlier bank," as stipulated under the Pillar 2 of Basel Framework.

Decline in economic value as of March 31, 2016 was around 2% of total capital, substantially below the 20% criterion.

(e) Management of Stocks Held for Strategic Purposes

SMBC establishes risk allowance limits on stocks held for strategic purposes and monitors the observance of these limits in order to control stock price fluctuation risk appropriately. More specifically, VaR (1 year holding period) computed from profit and loss simulations based on historical market fluctuation data and aggregated fluctuation in market price from the beginning of the fiscal year are subject to the risk capital limit management and monitored on a daily basis.

To diminish the impact of stock price movement on capital, SMBC has drawn up plans for reducing equity holdings. In accordance with these plans, which were announced in November 2015, SMBC is seeking to reduce its holdings^{*1} to a common equity Tier 1

(CET1) ratio of 14% over approximately five years from September 2015, when the level was 28%.

^{*1}: Holdings refers to Group holdings of stocks listed in Japan.

^{*2}: Based on full implementation under the Basel III framework

(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 upper limits for funding gaps," "maintaining supplementary liquidity," and "establishing contingency plans."

A funding gap is defined as the maturity mismatch between source of funds and use of funds, and shows forthcoming funding requirements. SMBC manages this funding gap properly by setting limits on the size of the gap and limiting reliance on short-term funding. These limits are set in place on both a bank-wide basis and individual branch basis, and take into account funding status, cash management planning, economic environments, and individual currency characteristics and other factors. Additionally, funding gap limits are set for individual currencies if necessary. SMBC monitors the funding gap on a daily basis.

Further, stress tests are regularly carried out by simulating the impact triggered, for example, by deposit outflows or difficulties in money market funding, in order to appraise and manage the amount of funding required when liquidity risk is realized. Additionally, supplementary liquidity is maintained by holding assets, such as U.S. government bonds, which can be immediately converted to cash, or establishing borrowing facilities to be used as supplementary funding sources in an emergency, in order to raise the required funds smoothly even during market disruption.

Furthermore, contingency plans are developed to respond to the liquidity risk when being realized, by creating detailed action plans such as lowering the upper limit for the funding gap, depending on the existing situation (i.e. normal, concerned, or critical) and the respective circumstances.

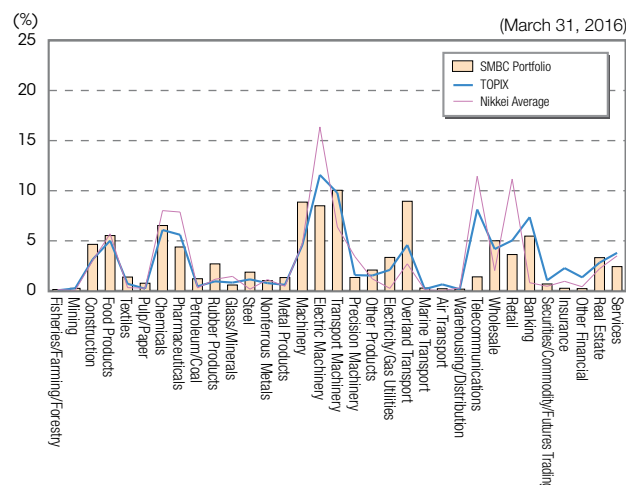
■ Decline in Economic Value Based on Outlier Framework

(Billions of yen)

	SMBC (consolidated)		SMBC (non-consolidated)	
	March 31, 2015	March 31, 2016	March 31, 2015	March 31, 2016
Total	132.6	215.0	117.9	193.4
Impact of Yen interest rates	21.2	48.0	17.3	43.9
Impact of U.S. dollar interest rates	57.4	109.7	52.6	99.6
Impact of Euro interest rates	25.5	40.1	24.5	38.7
Percentage of total capital	1.3%	2.1%	1.2%	2.0%

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



Operational Risk

1. Basic Approach to Operational Risk Management

(1) Definition of Operational Risk

Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Specifically, Basel Capital Accord—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.

(2) Fundamental Principles for Operational Risk 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 Capital Accord, SMFG has been continuously pursuing sophisticated quantification of operational risks and advanced group-wide management.

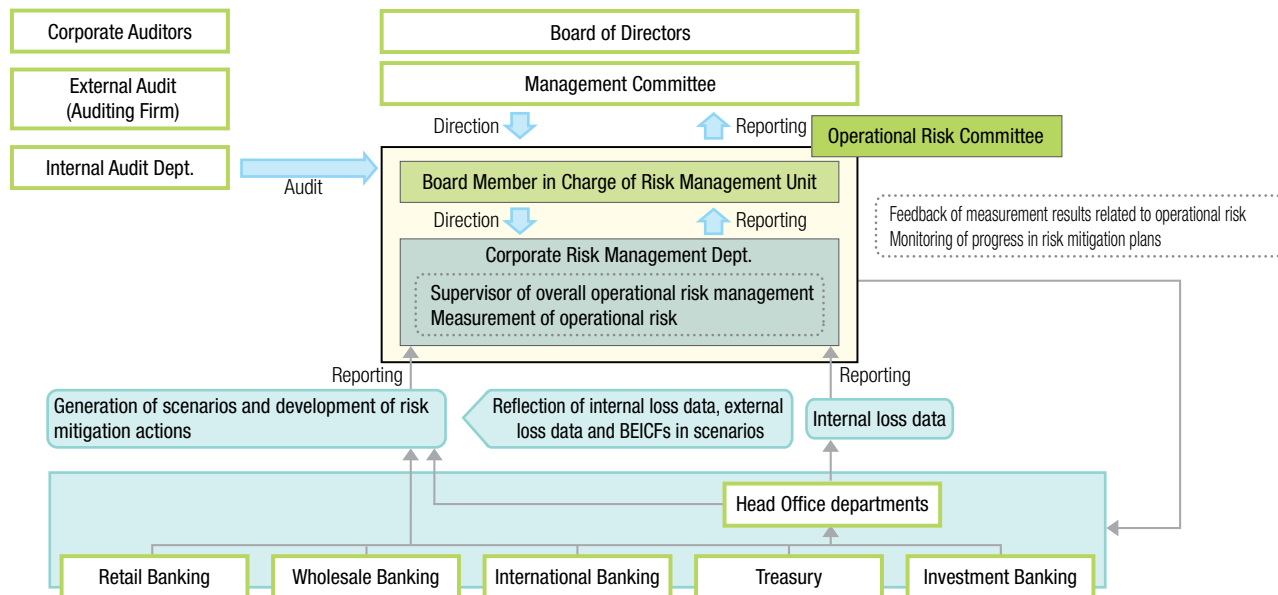
2. Operational Risk Management System

SMFG has designed and implemented an operational risk management framework for group-wide basic policies for risk management.

At SMBC, the Management Committee makes decisions on important matters such as basic policies for operational risk management, and these decisions are authorized by the SMBC's Board of Directors. In addition, SMBC has established the system to comprehensively manage operational risks by setting up the Corporate Risk Management Department to oversee overall management of operational risks together with other departments responsible for processing risks and system risks.

As a 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.

■ SMBC's Operational Risk Management System



These occurrences of internal loss data, severity of scenarios 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.

At the end of March 2008, SMFG and SMBC adopted the Advanced Measurement Approach (AMA) set forth by Basel Capital Accord for calculation of operational risk equivalent amount. The approach 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 operational risk equivalent amount and risk asset (operational risk equivalent amount 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.

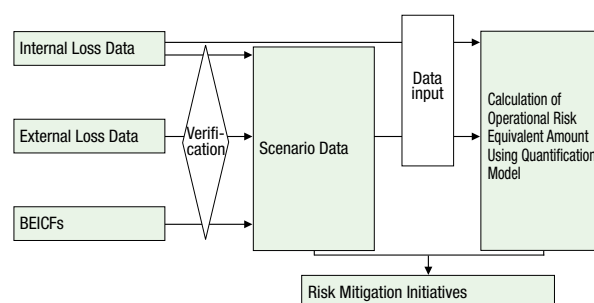
The purposes of scenario analysis are to identify any potential risks underlying in our business operations; to measure risks based on the possibility of occurrence of the said potential risks; and to review and execute any required measures. Furthermore, another purpose of the scenario analysis is to 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. Regarding the Consumer finance of a certain subsidiary, expected losses are excluded in calculating the operational risk equivalent amount of the repayment of excess interest.

Operational risk equivalent amount in respect of the “tangible asset damages” that occurred by earthquakes are measured using

Basic Framework of Operational Risk Measurement



the probability data of earthquake occurrence in each part of Japan and the distribution of loss amount by those earthquake occurrences.

The measurement units are SMFG consolidated basis, SMBC consolidated basis and SMBC non-consolidated basis. The operational risk equivalent amount based on AMA is calculated as the simple aggregate of the amount of the seven event types set forth by the Basel Capital Accord and of the “tangible asset damages” by earthquakes. However, in the case of SMFG consolidated basis, the risk of losses on repayment of excess interest is added on. The measurement accuracy is ensured by implementing the regularly conducted verifications of the quantification models pre- and post-measurement.

Meanwhile, as for the operational risk equivalent amount 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 operational risk equivalent amount for SMFG consolidated basis and SMBC consolidated basis are calculated by consolidating such amount calculated based on BIA with the operational risk equivalent amount 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

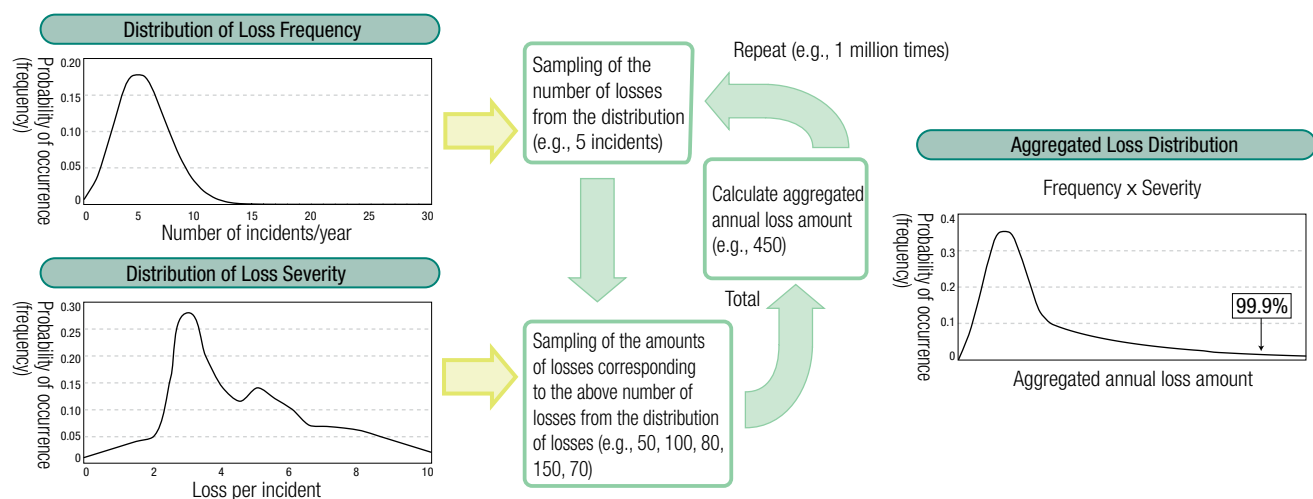
Processing risk is the possibility of losses arising from negligent processing by employees, accidents, or unauthorized activities.

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 group-wide 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 risk of loss arising from the failure, malfunction, or unauthorized use of information systems.

SMFG recognizes that the IT revolution makes reliable information systems essential for the effective implementation of management strategy. We strive to minimize system risk by drafting regulations and specific management standards, including a security policy. We also have contingency plans targeted at minimizing losses in the event of a system failure. This risk management system is designed to ensure 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). Systems trouble at financial institutions has the potential to impact heavily on society as system risk diversifies owing to advances in IT and financial institutions expand their fields of business. We have numerous measures in place for system breakdown prevention, including constant maintenance to ensure stable and uninterrupted operation, duplication of the various system categories and infrastructure, and a disaster-prevention system consisting of computer centers in eastern and western Japan. To maintain the confidentiality of customer data and prevent leaks of information, sensitive information is encrypted, unauthorized external access is blocked, and all possible measures are taken to secure data. We also have contingency plans and hold training sessions as necessary to ensure full preparedness in the event of an emergency. To maintain security, we will continue to revise countermeasures as new technologies and usage formats emerge.

Taking into account the growing sophistication and diversification of cyberattacks globally, the increasing social impact from damage inflicted by such attacks, and the risk to our reputation and credit standing, we deploy governance and technologies for identification, protection, and detection and we are continuously tightening this cyber security management in preparedness for attacks.

Settlement Risk

Settlement risk is the possibility of a loss arising from a transaction that cannot be settled as planned. As this risk crosses over numerous risks, including credit, liquidity, processing and system risks, it is required to appropriately manage according to characteristics of such risks.

At SMBC, the Corporate Risk Management Department is in overall charge of settlement risk, while settlement risk included within the various other risk categories is managed by the respective department in charge: the Credit & Investment Planning Department for credit risk, the Corporate Risk Management Department for liquidity risk, the Operations Planning Department for processing risk, and the IT Planning Department for system risk.

Glossary

ALM

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

Advanced Measurement Approach (AMA)

Based on the operational risk measurement methods used in the internal management of financial institutions, this is a method for obtaining the operational risk equivalent amount by calculating the maximum amount of operational risk loss expected over a period of one year, with a one-sided confidence interval of 99.9%.

Back-testing

Method of verifying the validity of models by comparing the model value and actual value. For instance, in the case of VaR, comparing and verifying the value of VaR and the profit or loss amount.

Basel III

The Basel Capital Accord, an international agreement, was amended in December 2010 for ensuring the soundness of banks (minimum capital requirements) for the purpose of enhancing the capabilities of appropriately responding to any financial and economic crisis and reducing risks which may have originated from financial sector to adversely affect the actual economy. It has been implemented incrementally since 2013.

Basic Indicator Approach (BIA)

A calculation approach in which an average value for the most recent three years derived by multiplying gross profit for the financial institution as a whole by certain level (15%) is deemed to be the operational risk equivalent amount.

BPV

Abbreviation for Basis Point Value
Potential change in present value of financial product corresponding to 0.01-percentage-point increase in interest rates.

Credit cost

Average losses expected to occur during the coming year.

Historical simulation method

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

LGD

Abbreviation for Loss Given Default
Percentage of loss assumed in the event of default by obligor; ratio of uncollectible amount of the exposure owned in the event of default.

Monte Carlo simulation method

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

Outlier framework

Monitoring standard for interest rate risk in the banking book, as set forth in the Pillar 2 of the Basel Capital Accord.

Operational risk equivalent amount

Operational risk capital requirements under the Basel Capital Accord capital adequacy regulations.

PD

Abbreviation for Probability of Default
Probability of becoming default by obligor during one year.

Present value

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

Risk appetite

Types and levels of risk that SMFG is willing to take on or tolerate to drive earnings growth.

Risk appetite framework

A framework in which SMFG's risk appetite is clarified and appropriately applied to its business operation.

Risk capital

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

Risk factor

Anything which may become a factor for risk. In the case of market risk, it would be the share price or interest rate; in the case of credit risk, it would be the default rate or economic environment.

Risk-weighted assets

- Credit risk
Total assets (lending exposures, including credit equivalent amount of off-balance sheet transactions, etc.) which is reevaluated according to the level of credit risk.
- Operational risk
Amount derived by dividing the operational risk equivalent amount by 8%.

Sound risk culture

Business culture in which SMFG seeks to achieve the appropriate balance between risk and return after determining the degree of risk that is acceptable.

Underlying assets

General term used for assets which serve as the source of payments for principal and interest for securitization exposures, etc.

VaR

Abbreviation for Value at Risk
The maximum loss expectation for a portfolio of financial assets for a given probability.