

RATING ACTION COMMENTARY

Fitch Affirms Ratings on SMBC at 'A', SMFG and Other Subsidiaries at 'A-'; Outlook Stable

Thu 24 Oct, 2024 - 6:28 ET

Fitch Ratings - Tokyo - 24 Oct 2024: Fitch Ratings has affirmed the Long-Term Issuer Default Ratings (IDRs) of Sumitomo Mitsui Financial Group, Inc. (SMFG) at 'A-' and its core bank, Sumitomo Mitsui Banking Corporation (SMBC; referred to as SMBC group together with SMFG) at 'A'. The Outlook is Stable.

At the same time, Fitch has affirmed the Short-Term IDRs at 'F1', the Viability Ratings (VRs) of the SMBC group at 'a-' and the Government Support Ratings (GSRs) at 'a-'. Fitch has also affirmed the support-driven IDRs of subsidiaries SMBC Bank EU AG (SMBCEU) and SMBC Bank International plc (SMBCBI) at 'A-', with a Stable Outlook.

KEY RATING DRIVERS

IDRs Driven by VRs: The Long-Term IDRs of SMFG and SMBC are anchored to the group VR. SMFG's Long-Term IDRs are aligned with the VR, while SMBC's are uplifted by one notch, as we expect senior creditors to benefit from resolution funds raised by the ultimate bank holding company, SMFG, in an orderly resolution process. SMBC is a material subsidiary under SMFG and its loss-absorbing capacity (LAC) represented more than 13% of the group's risk-weighted assets (RWAs) at end-March 2024. The VRs are in line with the implied group VR, factoring in SMBC group's strong franchise.

The uplift recognizes that the third-party senior creditors of SMBC could benefit from the LAC that has been built in the event of failure and a resolution under Specified Measure 2 of Article 126-2 of the Deposit Insurance Act (SM2), which reduces the risk of default for these creditors. We regard the probability of resolution under SM2 as low, as we think the government is more likely to provide pre-emptive support to troubled



operating environment factor score. The exit from the negative interest rate regime, a gradual rise in interest rates and rising asset prices should support an increase in revenue opportunities, although it would take time for profitability - the banks' weakest key rating driver - to show material and sustained improvement. Our assessment factors in global uncertainties and the pressure on Japan's growth from structural challenges.

Sound Business Profile: SMBC group's business profile factor score at 'a-' is constrained by the operating environment factor score. This is because we expect the operating environment, which features low interest rates and structural headwinds, to limit SMBC group's ability to generate sustainable earnings, notwithstanding its franchise and significant market share in Japan. SMBC group's position as one of the country's three-largest banking groups is complemented by its international network.

Sound Risk Management: SMBC group has retained its appetite for growth, which could erode the headroom at the current 'a-' risk profile factor score, if it is focused in regions where we believe the bank environment is weaker than Japan's and there is no increase in loss-absorption buffers commensurate with its growth expectations.

Still, the group has robust financial risk management and controls, including over the market risk on its securities portfolio, offsetting its higher risk appetite than at Japanese mega-bank peers. The group continues to transform its corporate culture to address non-financial risks, including regulatory, legal and reputational risks.

Stable Asset Quality: We expect SMBC group's asset quality to remain stable, with the non-performing loan/total loan ratio remaining at around 1.2% through to the financial year ending March 2027 (FYE27). The group's exposure to consumer finance and SMEs may leave asset quality more susceptible to economic downcycles than at peers, but the bank manages the risk well. Its non-loan asset exposure is primarily to securities of good quality.

Stable Profitability: We expect the group's operating profit/RWA ratio to be sustained at around 1.4% to FYE27. Earnings should be supported by sound corporate business growth and lower credit costs, partly offset by a slight increase in RWAs. We expect profitability to remain the weakest aspect of SMBC group's standalone profile.

Capitalisation to Weaken: We expect SMFG's common equity Tier 1 (CET1) ratio (currently 12.8%, or 11.2% excluding unrealised gains) to remain above 12% over the

Sound Funding Position: SMBC group's sound funding profile reflects a strong yen deposit base, which is a credit strength. The group's foreign-currency funding base is stable, helped by deposits and mid- to long-term bond issues and cross-currency swaps. The group also has access to central bank lines in foreign currency, if needed. This is reflected in the stable outlook on the 'a' funding and liquidity factor score.

Very High Likelihood of Support: SMBC group's GSR of 'a-' reflects our assessment that, like other systemically important banks in Japan, there is a very high probability the group will receive government support if needed. The government can pre-emptively provide financial assistance to a solvent bank holding company when a serious system disruption is anticipated under Japan's Deposit Insurance Act. We expect the state to maintain this stance to avoid financial market disruption. The GSR represents the lowest level the IDRs would be in the event of any deterioration in the group's standalone credit profile.

Consolidated Group VR: We assess SMBC group's VR on a consolidated basis, reflecting the functional interconnectedness between the group and the core bank, SMBC. This is in addition to the regulator's group-level focus, which makes government support equally likely for SMFG and SMBC. We assign the group VR to SMBC, as we believe the bank has substantially the same failure risk as the group. We also assign the group VR to the holding company, reflecting low double leverage and prudent liquidity management.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

GSRs

Any weakening in our assumptions about the sovereign's propensity or ability to provide timely support to SMBC group could lead to negative rating action on the GSRs. A downgrade of Japan's 'A' sovereign rating to 'A-', on its own, may not automatically lead to a downgrade of the GSRs. A downgrade of the sovereign rating, which is on a Stable Outlook, is less likely in the near term.

VRs

A lower operating environment score in the 'bbb' category, although very unlikely in the medium term, would lead to a downgrade of the VR. Developments that could otherwise

0.9% (FYE21-FYE24 average: 1.3%).

-- The four-year average non-performing loan ratio staying above 1.5% (FYE21-FYE24 average: 1.0%) or repeated unexpected and large impairments in the securities portfolio.

-- The CET1 ratio (including unrealised gains) staying below 12% without a credible plan to restore it to above this level (end-June 2024: 12.8%).

-- A downward revision in SMBC group's business profile, such as a shift to a less-stable business model and an increase in risk appetite, together with a deterioration in key financial rating factors.

IDRs

SMFG's Long-Term IDRs will not be downgraded unless there is concurrent negative rating action on its GSR and VR.

The Long-Term IDRs of SMBC will be downgraded if the group VR is downgraded or if we remove the one-notch uplift. The one-notch uplift could be removed if we no longer believe external senior creditors would be protected by junior debt instruments if the bank were to fail. This could result from a change in resolution legislation or the amount of debt and equity buffers available to SMBC in a resolution.

A downgrade of Japan's sovereign rating to 'A-' would also lead to a downgrade of SMBC's Long-Term IDR.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade

IDRs and GSRs

An upgrade of the sovereign rating could lead to positive rating action on the GSRs and SMFG's Long-Term IDRs. An upgrade of the group VR would lead to positive rating action on SMFG's Long-Term IDRs. An upgrade of SMBC's Long-Term IDRs would require an upgrade of both the group VR and the sovereign rating.

VRs

15%, supported by a broadly stable - if not improved - operating environment, could lead to positive rating action on the VRs.

OTHER DEBT AND ISSUER RATINGS: KEY RATING DRIVERS

Short-Term IDRs

SMFG's Short-Term IDRs are at the higher of the two options available at a Long-Term IDR of 'A-'. Its funding and liquidity factor score at 'a' meets our minimum criteria expectation for a Short-Term IDR at 'F1'. The rating is complemented by our expectation that government support is more certain in the short term.

SMBC's Short-Term IDRs are at the lower of the two options available at a Long-Term IDR of 'A'. Its funding and liquidity factor score of 'a' is below our minimum 'aa-' criteria expectation for a Short-Term IDR at 'F1+'.

Senior Debt

The senior unsecured debt ratings on SMBC's euro medium-term note programmes are aligned with its Long- and Short-Term IDRs, in line with Fitch's criteria.

SMFG's senior unsecured debt ratings are aligned with its IDRs. Japan does not have full depositor preference, so we equalise the bank holding company's senior debt ratings with the IDRs when the bank holding company's senior unsecured debt plus group junior debt buffers are more than 10% of group RWAs. SMFG's buffer was 11.0% as of end-March 2024.

OTHER DEBT AND ISSUER RATINGS: RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

Short-Term IDRs

The Short-Term IDRs of SMFG will remain at 'F1' unless the Long-Term IDRs are downgraded to 'BBB' or our funding and liquidity factor score is lowered to 'a-' or below at the same time the GSR is lowered to 'bbb+' or below.

A downgrade of SMBC's Short-Term IDR would require a downgrade of its Long-Term

SMFG's and SMBC's senior debt ratings would be downgraded if their respective IDRs are downgraded.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

Short-Term IDRs

The Short-Term IDRs of SMFG could be upgraded if the Long-Term IDRs are upgraded to 'A' and our funding and liquidity factor score is raised to 'aa-', which appears unlikely in the near term.

The Short-Term IDRs of SMBC could be upgraded if our funding and liquidity factor score is raised to 'aa-', which appears unlikely in the near term.

The Short-Term IDRs could also be upgraded if the GSRs are upgraded to 'a' to be in line with the sovereign Short-Term IDRs of 'F1+', as support is more likely in the short term.

Senior Debt

An upgrade of SMFG's or SMBC's IDRs would result in an upgrade of their respective senior debt ratings.

SUBSIDIARIES & AFFILIATES: KEY RATING DRIVERS

The Long-Term IDRs on SMBCBI and SMBCEU are driven by their Shareholder Support Ratings (SSRs), which are in line with SMFG's Long-Term IDR, the anchor rating. This is based on the subsidiaries' key roles within the group and the high level of group integration in business operations and management.

The Short-Term IDRs of SMBCBI and SMBCEU are at the higher of the two options available at a Long-Term IDR of 'A-' to reflect that support is more likely in the short term.

SUBSIDIARIES AND AFFILIATES: RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade:

A downgrade of SMFG's Short-Term IDR would lead to similar action on the subsidiaries' Short-Term IDRs.

Factors that Could, Individually or Collectively, Lead to Positive Rating Action/Upgrade:

Positive rating action on SMFG's Long-Term IDR is likely to lead to similar action on the subsidiaries' SSRs and Long-Term IDRs, provided SMBC group's propensity to support the subsidiaries remains unchanged.

The Long-Term IDRs on the subsidiaries may also be upgraded if significant resolution buffers are put in place and maintained at the subsidiaries.

An upgrade of SMFG's Short-Term IDR is likely to lead to similar action on the subsidiaries' Short-Term IDRs.

SUMMARY OF FINANCIAL ADJUSTMENTS

Total assets and total liabilities exclude acceptances and guarantees from Japan's generally accepted accounting principles balance sheet to be globally comparable.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

The IDRs on SMBCBI and SMBCEU are based on our view of support from the ultimate parent, SMFG, and are therefore linked to SMFG's Long-Term IDR.

ESG CONSIDERATIONS

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit

ENTITY / DEBT ↕	RATING ↕			PRIOR ↕
Sumitomo Mitsui Financial Group, Inc.	LT IDR	A-	Affirmed	A-
	ST IDR	F1	Affirmed	F1
	LC LT IDR	A-	Affirmed	A-
	LC ST IDR	F1	Affirmed	F1
	Viability	a-	Affirmed	a-
	Government Support	a-	Affirmed	a-
senior unsecured	LT	A-	Affirmed	A-
Sumitomo Mitsui Banking Corporation	LT IDR	A	Affirmed	A
	ST IDR	F1	Affirmed	F1
	LC LT IDR	A	Affirmed	A

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APPLICABLE CRITERIA

[Bank Rating Criteria \(pub. 16 Mar 2024\) \(including rating assumption sensitivity\)](#)

ADDITIONAL DISCLOSURES

[Dodd-Frank Rating Information Disclosure Form](#)

[Solicitation Status](#)

[Endorsement Policy](#)

ENDORSEMENT STATUS

SMBC Bank EU AG	EU Endorsed, UK Endorsed
SMBC Bank International plc	EU Endorsed, UK Endorsed
Sumitomo Mitsui Banking Corporation	EU Endorsed, UK Endorsed
Sumitomo Mitsui Financial Group, Inc.	EU Endorsed, UK Endorsed

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