FitchRatings

RATING ACTION COMMENTARY

Fitch Revises Outlook on SMFG to Negative; Affirms Ratings

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Fitch Ratings - Tokyo - 08 Apr 2020: Fitch Ratings has revised the Outlook on Long-Term Issuer Default Ratings (IDRs) of Sumitomo Mitsui Financial Group, Inc. (SMFG), Sumitomo Mitsui Banking Corporation (SMBC) and Sumitomo Mitsui Banking Corporation Europe Limited (SMBCE) to Negative from Stable. The IDRs at 'A' have been also affirmed for the entities. In addition, the Viability Ratings (VRs) at 'a' have been affirmed for SMFG and SMBC.

The Outlook revision on SMFG's IDR reflects Fitch's assessment that a weaker and more challenging operating environment for the Japanese banks caused by the coronavirus pandemic is likely to negatively affect SMFG's credit profile, although the extent of the economic and financial market effects is unclear. Fitch expects world economic activity to decline by 1.9% in 2020, with US GDP down by 3.3%, the eurozone 4.2% and Japan 2.7%, based on our Global Economic Outlook, dated 2 April 2020 (www.fitchratings.com/site/re/10116672), with further downside risks.

RATING ACTIONS

ENTITY/DEBT	RATING			PR
Sumitomo Mitsui Financial Group, Inc.	LT IDR	A	Affirmed	A
	ST IDR	F1	Affirmed	F1

ENTITY/DEBT	RATING			PR
	LC LT IDR	A	Affirmed	A
	LC ST IDR	F1	Affirmed	F1
	Viability	a	Affirmed	a

VIEW ADDITIONAL RATING DETAILS

KEY RATING DRIVERS

IDRS, SUPPORT RATINGS, SUPPORT RATING FLOORS AND VIABILITY RATINGS

SMFG's IDR is driven by its VR, which reflects its intrinsic credit profile, with its strong capitalisation and stable funding base, steady asset quality and its strong franchise as one of the largest banking groups in Japan.

The VR also factors in modest yet higher profitability than other domestic mega bank peers. SMFG's profitability has been already under pressure, like other domestic banks, due to domestic structural challenges. Pandemic-related risks to its operating environment could further deteriorate its earnings profile with additional profitability challenges, including increases in credit costs. The weakened operating environment could expose the bank to deterioration in its asset quality, which would be reflected in loans to SMEs or to the sectors vulnerable to the economic and market conditions. However, Fitch expects the bank to maintain higher profitability than its domestic mega bank peers because of its diversified revenue and the contribution from the group's consumer finance business.

Fitch expects SMFG's capitalisation will remain strong and capital ratios sustained above those of its peers, with sound risk-absorption buffers. Fitch anticipates that the buffer would help mitigate potential impacts from financial market fallout. However, an increase in SMFG's risk appetite to accelerate revenue growth without adequate risk buffers could expose its capital to higher volatility.

The solid liquidity from a strong deposit base in Japan remains unchanged. SMFG's foreign-currency funding will be supported by its diversified funding, including deposits and cross-currency swaps.

SUBORDINATED DEBT

The Basel III Tier 2 instruments issued by SMFG are notched down twice from the issuer's IDR to reflect poor recovery expectations, which is consistent with the base case in Fitch's revised Bank Rating Criteria published 28 February 2020. The instruments will be fully and permanently written down upon reaching the point of non-viability. The anchor rating for the instrument is the IDR because Fitch believes that support can be factored into such instrument ratings as the government can pre-emptively provide financial assistance to systemically important financial institutions.

SUBSIDIARY

The IDR of SMBCE is in line with the rating of its 100% parent, SMBC, the operating bank under SMFG, reflecting its role as one of SMBC's European operational arms.

RATING SENSITIVITIES

IDRS, SUPPORT RATINGS AND SUPPORT RATING FLOORS

Factors that could, individually or collectively, lead to negative rating action/downgrade:

SMFG's IDR is sensitive to negative rating action on the Japanese sovereign (A/Stable).

Any downward rating action in the VR would result in a similar change to the respective IDRs, however, this will be limited to one notch while the Support Rating Floor (SRF) is at 'A-'.

The Support Rating and SRF could be negatively affected if Fitch believes there is a lower propensity for the sovereign to support the bank or if the ability of the sovereign to provide timely support deteriorates significantly.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The SRF and IDR could be positively affected if the sovereign rating is upgraded. However, this appears unlikely because of the current economic outlook.

VIABILITY RATINGS

Factors that could, individually or collectively, lead to negative rating action/downgrade:

The ratings remain sensitive to the extent of the pandemic-related global economic slowdown. Further pressure on the operating environment, such as a more prolonged downturn than Fitch's current base case, could lower the operating environment factor mid-point to 'bbb+' from 'a-'. This would in turn weigh on the VRs as it would change the implied benchmark mid-point for the financial profile factors.

A sharp deterioration its earnings profile or limited prospects for profitability improvement due to weaker asset quality with an increasing trend of the non-performing loan (NPL) ratio and credit costs, leading to deterioration of capitalisation, could negatively affect the rating.

A prolonged deterioration in SMFG's capitalisation with a decline in the common equity Tier 1 ratio, consistently below 15% (16% at December-end 2019), which could be accompanied by lower profitability with the operating profit/risk-weighted assets ratio remaining below 1.2% (1.7% at March-end 2019), driven by weaker asset quality with the NPL ratio sustained above 1.5% (0.8% at December-end 2019), could lead to a downward action on the VR even if the operating environment factor mid-point remains at 'a-'.

A substantial increase in risk appetite, which may be driven by increased exposure to securities with higher risks, weaken risk controls in pursuit of higher returns or a substantial overseas expansion, without accumulation of adequate loss-absorption buffers, could also adversely affect its rating.

The VRs of subsidiaries are also sensitive to holding-company considerations, including maintenance of double leverage ratio below 120% as well as the supervisory approach of the regulatory authorities, which is conducted on a consolidated basis.

SMFG's VR is sensitive to negative rating action on the Japanese sovereign.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

Potential upside for the rating is limited in light of the rating proximity to Japan's sovereign rating.

SUBORDINATED DEBT

Factors that could, individually or collectively, lead to negative rating action/upgrade:

A downgrade of IDR would lower the subordinated debt rating.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

SMFG's debt ratings on the Tier 2 instruments are sensitive to a positive rating action on its IDR, which is the anchor rating.

SUBSIDIARY

Factors that could, individually or collectively, lead to negative rating action/upgrade:

Any negative change in the rating of SMBC would lead to a downward rating action on SMBCE. SMBCE's ratings could be also lowered should SMBC's propensity to support SMBCE decline significantly, although Fitch does not expect such changes in the medium term.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

The ratings of SMBCE would be affected by a positive rating action on SMBC's IDR.

BEST/WORST CASE RATING SCENARIO

Ratings of financial institution issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of four notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit www.fitchratings.com/site/re/10111579.

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.

ESG CONSIDERATIONS

ESG issues are credit neutral or have only a minimal credit impact on the entity(ies), either due to their nature or the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Additional information is available on www.fitchratings.com

APPLICABLE CRITERIA

Non-Bank Financial Institutions Rating Criteria (pub. 29 Feb 2020) (including rating assumption sensitivity)

Bank Rating Criteria (pub. 29 Feb 2020) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

Sumitomo Mitsui Banking Corporation	EU Endorsed
Sumitomo Mitsui Banking Corporation Europe Limited (SMBCE)	EU Endorsed
Sumitomo Mitsui Financial Group, Inc.	EU Endorsed

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Japan   United Kingdom