



SMBC

SUMITOMO MITSUI BANKING CORPORATION
EUROPE LIMITED

Pillar 3 Disclosures

(As of 31st March 2013)

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Document disclaimer

- The purpose of the Pillar 3 disclosures as contained within this Disclosure Document is solely to explain the basis according to which Sumitomo Mitsui Banking Corporation Europe Limited (“SMBCE” or “the Bank”) complies with certain capital related requirements and to provide information about the management of risks relating to those requirements.
- This Disclosure Document does not constitute any form of financial statement on behalf of the Bank and should be read in conjunction with the Bank’s Annual Report & Financial Statements.
- This Disclosure Document reflects, where appropriate, information which is contained within the Bank’s Annual Report & Financial Statements.
- The Information has been subject to internal review, but has not been audited by the Bank’s external auditors.
- Although Pillar 3 disclosures are designed to provide transparent capital disclosure by banks on a common basis, the information contained in this particular Disclosure Document may not be directly comparable with that made available by other banks. This may be due to a number of factors such as:
 - The mix of approaches allowed under the Capital Requirements Directive (“CRD”),
 - The mix of corporate exposure types between banks,
 - The different risk appetites and profiles of banks,
 - The different waivers applied for and allowed by the PRA.
- Pillar 2 capital requirements are excluded from this Disclosure Document, but nevertheless play a major role in determining both the total capital requirements of the Bank and any surplus capital available.

1. Overview

1.1 Background

The ongoing capital requirements for international banks are governed on an overall basis by a capital accord formulated by the Basel Committee on Banking Supervision, commonly referred to as Basel 2. The framework involves a three-pillar approach, with each individual Pillar being an important and mutually reinforcing element in determining the overall capital which an institution needs to have in place:

- Pillar 1 is Minimum & Enhanced Capital Requirement (quantification of credit risk, market risk and operational risk).
- Pillar 2 is Supervisory Review (involving Individual Capital Guidance & Assessment by the regulator based on consideration of Risk and Business & Control Risk Factors. This enables capture of other wider general risks).
- Pillar 3 is Market Discipline (this involves frequent and forward looking disclosure set by the regulator).

In the case of banks in the EU, implementation of Basel 2 was achieved via the Capital Requirements Directive (“CRD”). The CRD came into effect in the EU as at the beginning of 2007. This provided the formal legislative framework to be reflected in the detailed rules and requirements which are imposed by each local regulator. The Bank is regulated by the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”).

The relevant requirements are contained in BIPRU (The Prudential Sourcebook for Banks, Building Societies and Investment), and GENPRU (the General Prudential Sourcebook).

BIPRU Section 11 lays out the disclosure requirements applicable to banks and building societies, in accordance with Pillar 3. The Section 11 requirements are designed to promote market discipline by providing market participants with key information on a firm’s risk exposures, risk management processes, and capital adequacy. Improved public disclosures of such information is intended to ensure increased transparency and hence more effective market discipline.

The PRA granted SMBCE permission to use an Internal Ratings Based (“IRB”) approach to credit risk and capital management, alongside the Standardised approach for certain assets (as outlined in more detail in subsequent sections of this document) in December 2007. The Bank has therefore been subject to the relevant BIPRU and GENPRU requirements since January 2008.

After due consideration of the size and complexity of operations, the Bank determined that it would make the necessary Pillar 3 disclosures within a Disclosure Document to be issued on an annual basis. The first Pillar 3 Disclosures were made as of 31st March 2009 (covering the first full financial year for which the requirements existed).

1.2 Disclosure overview

In accordance with the BIPRU section 11 requirements, the Bank has prepared this Disclosure Document presenting the internal status as at 31st March 2013.

The Disclosure Document contains both qualitative and quantitative information, concerning the following areas:

- **Governance** (section 2);
- **Risk Management**; both in relation to overall risk management issues and specific risk categories (sections 3 – 8);
- **Capital structure and adequacy** (sections 9 – 10)

In addition section 11 provides a more detailed analysis of the Bank's credit portfolio and associated capital requirements in relation thereto.

1.3 Basis and Frequency of Disclosures

These disclosures are based on 31st March 2013 year end data.

After due consideration of the size and complexity of operations, the Bank has determined that the Disclosure Document will be formally updated on an annual basis, to reflect the situation as at the end of each financial year. However, any material change in the approaches or permissions used to calculate capital requirements will be disclosed as it arises.

1.4 Consolidation basis

SMBCE is authorised as a UK bank by the PRA ("PRA") and is regulated by the FCA and PRA.

SMBCE is required by the FSA to produce consolidated regulated reports, including its branches in France, Italy and the Netherlands, in order to assess its capital resources and capital requirements.

This Disclosure Document therefore relates to the SMBCE group.

1.5 Location and verification

This Disclosure Document has been reviewed by the Bank's senior management but has not been subject to external audit. However, where data is equivalent to that included in the Bank's Annual Report and Financial Statements, then such data has been subject to external audit during the formal review and verification process.

The Disclosure Document is published on the Bank's corporate website, which is felt to be the most appropriate mechanism to ensure that there is maximum transparency as per BIPRU Section 11.

This can be found at <https://www.smbcgroup.com/emea/info/smbce>

2. Governance

2.1 Overview

The Bank has in place a structure to ensure responsibilities are clear for the management of all significant risks. Key elements of these responsibilities are as follows:

The SMBCE Board is responsible for the exercise of effective management oversight of key risks.

The Executive Committee is responsible for the supervision and management of the Bank's daily operations and for overseeing the work of the Risk Committees. As part of this responsibility, the Executive Committee reviews and monitors the most significant risk issues. The Executive Committee meets monthly.

The Audit, Risk and Compliance Committee is principally responsible for considering the Bank's risk management structure and systems, the main areas of risk faced by the Bank, key matters arising in the Risk Committee meetings, annual financial statements, external audit arrangements, Internal Audit and Credit Review oversight, monitoring the Bank's risk management and internal control systems, and the appointment and dismissal of the senior management members of the Audit Department. The Audit, Risk and Compliance Committee meets quarterly and reports to the Board of Directors.

The Nomination Committee is responsible for assessing and recommending candidates to the Board to fill Board, General Manager and Significant Influence Function (as defined by the FSA) vacancies as and when they arise.

The Remuneration and Human Resources Committee is responsible for assessing the appropriateness of and approving the remuneration of the Bank's Directors and certain other members of management. It also has responsibility for other Board level remuneration and human resource matters, such as approving the Bank's remuneration policy and considering the level of staff turnover. The Remuneration and Human Resources Committee meets quarterly and reports to the Board of Directors.

Risk Committees - The Bank has established three Risk Committees, which report to the Executive Committee and the Audit, Risk and Compliance Committee. These Committees have responsibility for considering the risks to which the Bank is exposed, as follows:

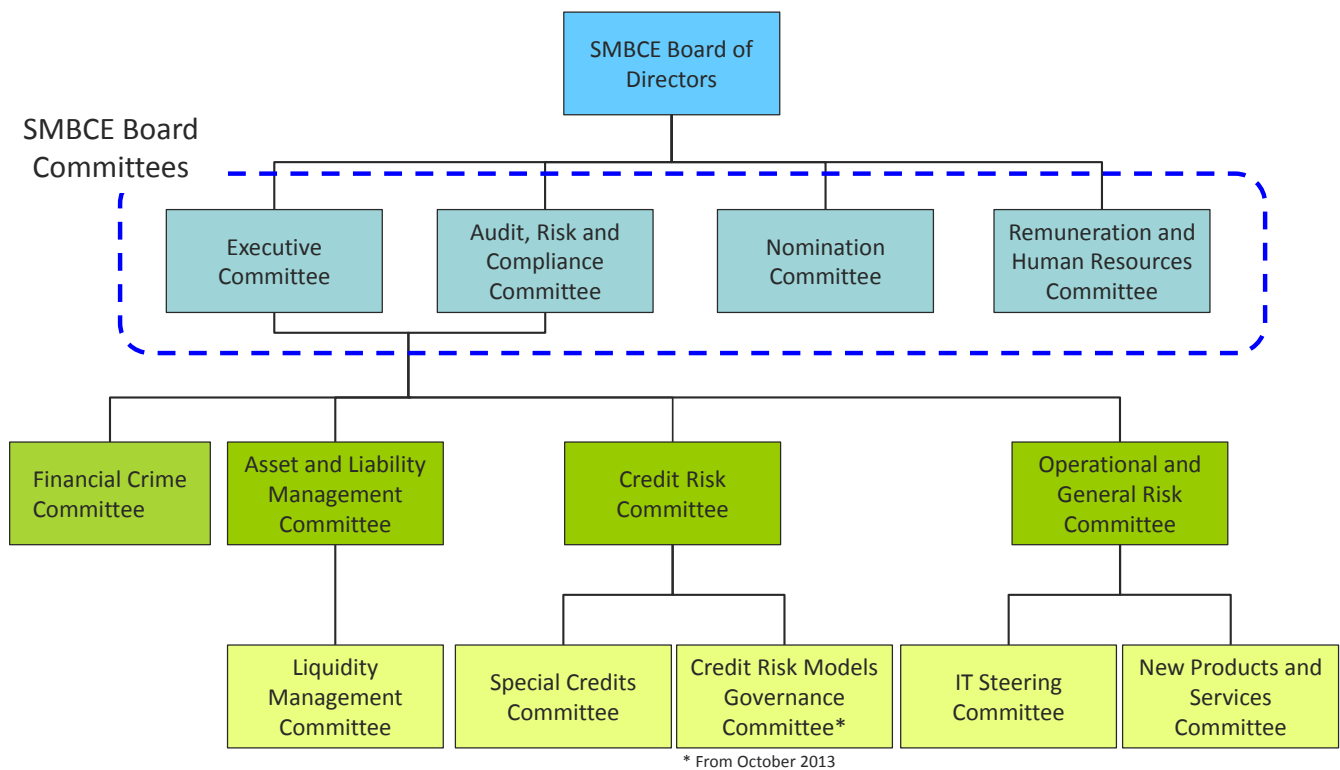
- Financial crime and related reputational risks are considered by the Financial Crime Committee;
- Market and Liquidity Risk issues are monitored at the Asset and Liability Management Committee;
- Credit Risk issues are monitored at the Credit Risk Committee ; and
- Operational Risks are monitored at the Operational and General Risk Committee ("OGRC").

In addition, the OGRC has responsibility for examining the risks associated with new products and services (in conjunction with its New Products and Services sub-committee) and major project and business change activity. This Committee also examines a number of other risk areas, including: IT, the business continuity plan, human resources, legal, regulatory compliance, and reputational risk.

The following Sub-Committees have also been established:

- Liquidity Management Committee (Sub-Committee of Asset and Liability Management Committee), which is responsible for considering issues relating to liquidity risk management, including analysis of the funding market, stress testing results, impact of business strategy on assets and deposits and funding strategy;
- Special Credits Committee (Sub-Committee of Credit Risk Committee), which is responsible for considering issues relating to, and the status of, Special Credit borrowers;
- Credit Risk Models Governance Committee (Sub-Committee of Credit Risk Committee), which is responsible for considering issues relating to credit risk models; (from October 2013, held once every 2 months)
- IT Steering Committee (Sub-Committee of OGRC), which is primarily responsible for examining IT projects and IT policies and strategies including global initiatives and how these apply to the Bank, and

New Products and Services Committee (Sub-Committee of OGRC), which is responsible for examining risks arising from the implementation of new products and services in order to support the risk analysis of the relevant departments. The Committee can also recommend that new products or services undergo the final approval process before their implementation. The Committee structure is represented in the diagram below:



2.2 Relationship with Parent

As a 100% subsidiary of Sumitomo Mitsui Banking Corporation (“SMBC”), SMBCE will in general seek to ensure alignment of strategy in important areas and to ensure cost-effective and consistent approaches across the group, where appropriate.

The Bank therefore follows overall SMBC group policy in assessing and managing risks and uncertainties.

However, the Bank's management will at all times ensure local relevance in order to support achievement of local objectives.

3. Risk Management Framework

3.1 Importance of Risk Management

The role of the overall risk management framework is to ensure that the Bank adopts and pursues appropriate business objectives which fully recognize the inherent risks of the business environment, including macro-economic, political and regulatory factors.

SMBCE categorises its risks into five principal risk categories, broadly based on the SMBC risk categorisations:

- Credit Risk – the risk of any losses the Bank may incur due the reduction or loss of the value of assets (including off-balance sheet assets) arising from any credit events, such as the deterioration of a borrowers financial standing.
- Market Risk – the possibility that fluctuations in interest rates, foreign exchange rates, or stock prices will change the market value of financial products, leading to a loss.
- Liquidity Risk – the possibility of encountering an obstacle to raising the funds required for settlement due either to a mismatch between the use and procurement of funds or to an unexpected outflow of funds, or being forced to borrow at higher interest rates than usual.
- Operational Risk – the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events, including legal risks.
- Other risks – not noted above.

The Bank wishes to ensure that risks are understood as comprehensively and consistently as possible across the risk spectrum. The above list should not be considered exhaustive as the Bank is also exposed to other potential risks and uncertainties.

3.2 Integrated Risk Management Vision

Risk management is a key discipline to manage and grow the Bank.

The Bank's Risk Appetite describes the business objectives and the qualitative and quantitative statements that restrict the amount of risk SMBCE is willing to take. As a Board level tool, the definition of Risk Appetite is aligned to the high level realisation of business strategy, and the guiding principles according to which the organisation is run. This is achieved by identifying certain critical areas, where the organisational strategy is most inextricably impacted by risk. These areas are identified as:

- Capital;
- Liquidity and funding;
- Earnings;
- Non-financial risks; and
- Profitability.

3.3 Culture

Culture and ethics in banking has been a strong and increasing area of focus for regulators over the past two years, and it will continue to be so for the foreseeable future.

Risk culture describes the values, beliefs, knowledge and understanding about risk shared by an organisation. The Bank needs to take risks to achieve its objectives and the prevailing risk culture can make it significantly better or worse at managing these risks. Risk culture significantly affects the capability to take strategic risk decisions and deliver on performance promises.

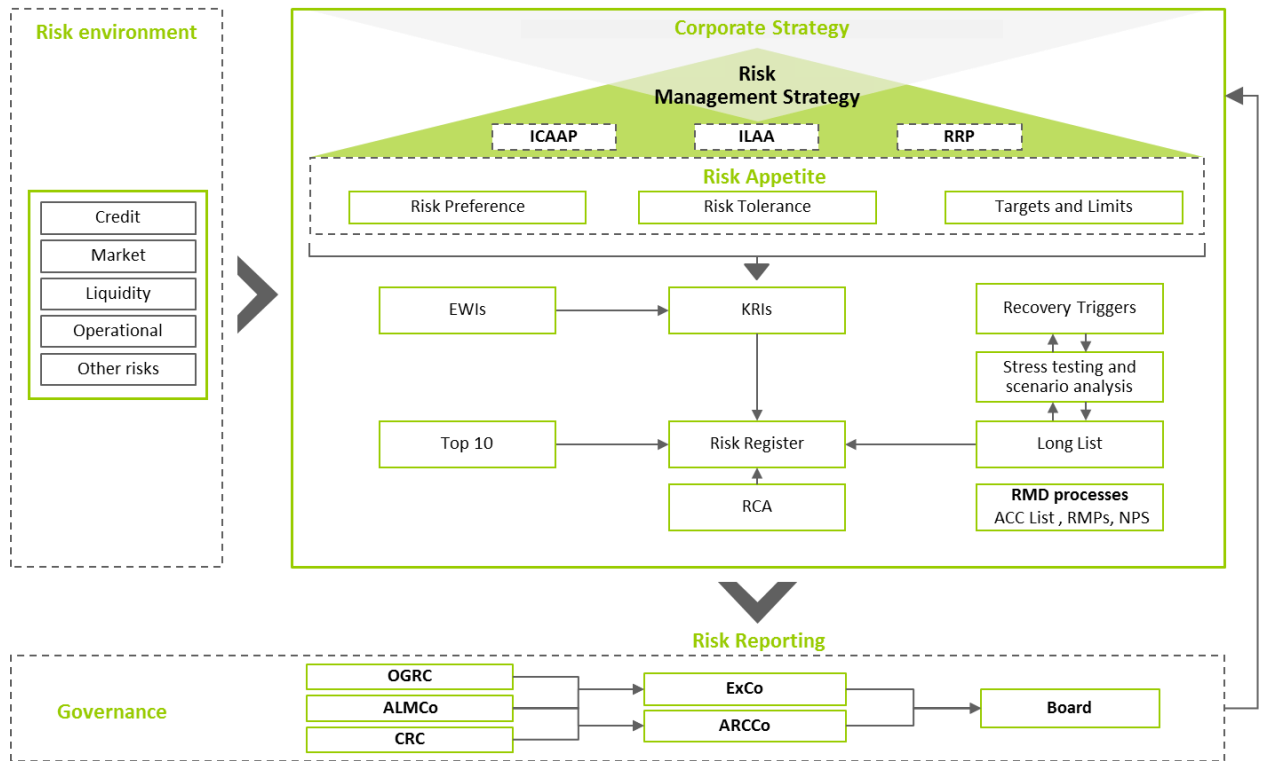
Management believes that the Bank has a strong risk focused corporate culture.

4. Integrated Risk Management Framework

4.1 Overview

To assist in the timely identification and holistic management and reporting of key risks, SMBCE has established an Integrated Risk Management (“IRM”) Framework, which contains a number of key elements. This is represented diagrammatically below, and a brief explanation of key elements is also included:

4.2 Integrated Risk Management Framework



Risk Appetite

The purpose of Risk Appetite is to define the broad-based level of risk that the entity is able and willing to undertake in pursuit of its objectives. The Risk Appetite ensures formal identification and consensus about the strategic level risks which the Bank is facing, and is a key tool for the business.

The Risk Appetite framework consists of three levels: Risk Preference, Risk Tolerance and 'Targets and Limits'. Risk Appetite is linked to overall business strategy, including assessment of new business opportunities, liquidity, funding and capital planning.

In order to really apply Risk Appetite within the business, all three of these elements are necessary and inter-connected requirements. The status of the Risk Tolerance is reported monthly to the Executive Committee, and also to the Board.

The risk appetite approach ensures that alignment of key supporting elements such as the Internal Capital Adequacy Assessment Process ("ICAAP") and Individual Liquidity Adequacy Assessment ("ILAA"). are structured appropriately to ensure that the Bank is at all times able to demonstrate that it has, and will have even in stressed conditions, adequate capital and liquidity available given its risk profile.

The Recovery Plan and Resolution Pack ("RRP") is a regulatory requirement whereby the Bank has to create a "Living Wills" to be submitted to the UK PRA. The main purpose of the RRP document is to provide sufficient information which is to be utilized by the regulators to liquidate the business in being specific circumstances whereby due to lack of liquidity and capital the Bank has to cease its activity

Risk management processes

A variety of processes have been established to ensure that the level for each risk within the risk environment can be measured using appropriate metrics and methodology, including a robust structure of risk limits and risk indicators.

Risk limits are set using a combination of operating limits, ratios and targets (measured against actual and potential risk including stressed conditions).

Key Risk Indicators ("KRIs")

KRIs seek to identify potential risk areas and/or issues that provide insights into a bank's risk position.

KRIs are presented to the appropriate risk committee (Asset and Liability Management Committee, Credit Risk Committee or Operational and General Risk Committee). The relevant risk committee receives a detailed analysis of the appropriate KRI showing the individual components of the KRI and explanation (or management actions as appropriate) for any red or amber KRIs or KRI elements.

Stress Testing

Stress testing is a key tool to model the impact of low-frequency, extreme impact events that might not be appropriately captured by more normal risk management techniques. Stress testing is an essential part of the Bank's risk management processes, to ensure that the Bank can adequately understand and quantify not just risks as they currently exist, but as they might develop in times of economic stress.

The potential impact upon adequacy of resources must be understood in relation to both capital adequacy and liquidity management in particular. Ensuring that the appropriate work is undertaken and included with regards to both the ICAAP and ILAA related work being undertaken in the Bank has been an area to which close attention is being paid.

Reverse stress tests, in which scenarios so severe as to render the Bank's business model unviable, are also implemented on a regular basis in order to highlight potential area of weaknesses. The aim of the

reverse stress testing is to encourage senior management to explore the vulnerabilities and fault lines in its business model, including “tail risks”.

Risk Monitoring

The comprehensive assessment of risks and controls is performed in a number of ways. This is approached in a holistic manner as the close involvement of all areas of the bank is essential to ensure that the processes for assessing the appropriateness and effectiveness of key risks and their controls, and capturing emerging risks are in place. The Bank uses a “Top 10” risk approach which was based on the outcome of the three Risk Committees, namely ALM, CRC and OGRC.. The objective of the Top 10 Risks listing is to develop a consensus about the most important risks facing the Bank. Each month Senior Management in RMD review the existing Top 10 Risks and evaluate any potential new items for inclusion. The Top 10 Risks are presented to Executive Committee and ARCCo.

The process is a dynamic and proactive part of the risk assessment toolkit, which promotes debate and challenge, and helps prioritise mitigation measures.

The Bank’s overall risk monitoring processes are designed to capture current and emerging risks. As a general principle, risk owners are responsible for monitoring their risks in order to identify any significant changes to their current risk assessment (i.e. changes to the size of their inherent risk or to the level of mitigation of their risk). Risk owners must report any material changes to management. Material and significant risk (including material changes to risk and/or the level of mitigation or control) are to be reported to management and committees in a timely and effective manner in order to fulfill SMBCE’s risk management governance requirements.

Risk Register

The Risk Register is maintained to reflect the key risks facing the Bank, and which could impact on the achievement of its primary strategic objectives, as set out in the Corporate Strategy. In this way the Bank ensures that appropriate controls are in place for those risks that are either most likely to materialise, or may have the greatest impact.

The Risk Register is updated by reviewing the overall risk universe (which covers all risks faced by the banking industry in general, including those that are not specifically relevant to SMBCE’s current business model or the Bank’s Corporate Strategy). These risks are reviewed to identify those that are considered material to SMBCE. The objective of the materiality assessment is to identify risks that need further consideration by the Bank, and those that do not. Materiality is assessed both before and after taking into consideration any existing controls.

New Product or Service

A New Product or Service (NPS) is defined as:

- A line of business, service, technique, or device not currently in use in the applying office; and/or
- Any combination or variation of existing approved product(s) and/or service(s).

New activities need to be subject to an appropriate degree of internal scrutiny. This ensures that all aspects of potential risks are considered in a timely manner before commencement, rather than after the event.

Risks associated with a NPS are monitored via the completion of the NPS Questionnaire and presentation to the New Products and Services Committee. The aim of the NPS process is business facilitation.

5. Credit Risk Management

5.1 Current status

SMBCE obtained approval from the UK PRA to calculate its Pillar 1 credit risk capital calculations using a Foundation Internal Ratings-Based (“IRB”) approach from 1st January 2008, using internal Probability of Default (“PD”) rates, with Loss Given Default (“LGD”) as per regulatory guidance for Japanese corporate, financial institutions and sovereign lending only.

Other assets are rated using the non-Japanese corporate model and are calculated for regulatory capital purposes according to the Standardised Approach.

Specialised lending uses supervisory slotting calculations for its regulatory capital calculations.

There were no changes to the regulatory approvals during the year ending 31st March 2013.

5.2 Board responsibility

As the most senior body within the Bank, SMBCE’s Board has responsibility for approval of certain key operating policies, including those which relate to the governance of Credit Risk. The Board oversees all elements of the Bank’s Credit Risk management structures and, in order to perform its role effectively, receives regular reports on all critical credit-related issues.

The Credit Risk Committee (“CRC”) is the internal committee directly responsible for strategic matters associated with the governance of credit risk. The CRC reports to the Executive Committee and Audit, Risk and Compliance Committee.

The SMBCE Board has established the rules for approval of individual transactions, which is a key part of the Bank’s day-to-day governance of credit risk. Specific approval authority levels have been established and these are reviewed on an annual basis. The General Manager of Credit Department, the COO and the CEO have authority to approve transactions up to certain limits. Should a transaction exceed the COO and CEO’s approval authority, the approval of a meeting comprising the CEO, one non-executive Director and one executive Director acting together is also necessary.

The Chief Risk Officer has the authority to exercise a right of veto in respect of any credit and underwriting transactions.

Although SMBCE is an independent entity, it operates within the context of the overall corporate governance structure of the SMFG group. The SMFG group has adopted an integrated approach to various aspects of credit risk management on a global basis, to ensure that resources and structures are harnessed in the most effective manner.

5.3 Importance of independent credit assessment

SMBCE utilises obligor and facility grading systems to assess the credit risk of individual transactions and capture the credit risk of the credit portfolio. Generally, the credit risk of the portfolio can be divided between credit cost (Expected Loss ["EL"]) and credit risk capital (Unexpected Loss ["UL"]). The Bank provides against EL with loss provisions and against UL with capital. All credits include probability of default, regardless of quality; thus, the credit risk of the credit portfolio must be controlled by assigning Obligor Grades and Facility Grades. To support any credit decision, the credit risk associated with the specific transaction which is under consideration must be assessed.

SMBCE's assessments do not necessarily match external ratings (ratings published by rating agencies) for a variety of reasons, including:

- Rating agencies do not always have the same perspective as banks;
- Rating agencies may have access to different information;
- Rating assessment models used by rating agencies may take a different approach, such as Moody's KMV EDF¹ model; and
- Rating agencies may also have different updating schedules.

5.4 Rating systems

SMBCE utilises a number of different internally developed rating systems and processes in the credit assessment process, reflecting different asset classes involved, with separate systems used for different assets including:

- Corporates (both Japanese and non-Japanese)
- Banks
- Securities companies
- Insurance companies
- Public Sector (including central governments and central banks)
- Project finance
- Aircraft finance
- Ship finance
- Property finance
- Purchased Claims

1, EDF is the expected default frequency within one year calculated based on stock price movement and other factors.

5.5 Assignment of Obligor and Facility Grades

In the case of both Obligor Grades and Facility Grades, detailed procedures document the approach which must be followed to ensure that the assessment is carried out appropriately.

An Obligor Grade indicates the credit risk of a company. To ensure allocation of obligor rating (and hence to assign an appropriate level in terms of internal PD), the first step is to undertake a detailed analysis of credit quality by use of the appropriate model. Obligor Grades are determined through a 3-step process – quantitative assessment, qualitative assessment, and self-assessment. Maintaining the integrity of Obligor Grades is critical for transaction and portfolio decision-making.

Obligor Grades range from 1 (the least risky) to 10 (the riskiest), with a common scale on a global basis across the SMBC group.

As part of this approach, and reflecting different market conditions, the Bank differentiates between Japanese and non-Japanese customers. Japanese corporates are assigned a “J series” Obligor grade and non-Japanese corporates are distinguished as being “G series”. The Bank also adopts a consolidated approach to assignment of grades to subsidiaries, meaning that when a Consolidated Subsidiary Grade is assigned, the same notation and methodology as those of the parent company are applied. Thus, almost all overseas Japanese companies will have J-grades.

A Facility Grade indicates the credit risk of an individual transaction and is determined by modifying the Obligor Grade according to the level of risk associated with conditions of the facility itself. The Facility Grade procedures require a formal assessment of pertinent factors, such as:

- Guarantees
- Third party assurances
- Tenor
- Collateral
- Purpose/structure
- Country ceiling/ transfer risk

5.6 Country Ceiling

In general, an Obligor Grade will not exceed the sovereign (government or central bank) grade of the country of domicile. In line with the approach of S&P, Moody's and other rating agencies which assess country risk and use the ratings as the ceiling for individual obligor rating SMBCE applies the country rating ceiling.

5.7 Internal Rating System grades

The calibration of the internal grade structure is shown below:

G grade	J grade	Borrower's Category
Code	Code	
G1	J1	Normal Borrowers
G2	J2	
G3	J3	
G4	J4	
G5	J5	
G6	J6	
G7	J7	Borrowers requiring caution
G7R	J7R	Substandard Borrowers
G8	J8	Potentially Bankrupt Borrowers
G9	J9	Virtually Bankrupt Borrowers
G10	J10	Bankrupt Borrowers

As the internal rating system, G7R and J7R or below grades are recognised as "Default" in terms of CRD in line with BIPRU default definition.

5.8 Use of the IRB approach

The use of the IRB approach forms an integral part of the Bank's credit approval process.

Each transaction is accompanied by an analysis of the return generated on a risk-adjusted basis to assess the profitability of transactions considering credit cost (i.e. expected loss) and capital cost, via the calculation of the "Risk Adjusted Return on Capital" or "RAROC", and "Sumitomo Mitsui Value Added" or "SMVA". These calculations take into account the economic capital which will be required to support any particular transaction, including Credit, Market, Operational and Liquidity Risk capital allocations. Tools, training and guidance are provided to business areas to ensure that this assessment is done in a consistent manner.

Another factor which will be taken into account is the extent to which provision of credit to a customer, industry group or country may give rise to particular concentrations of exposure.

There are, of course, wide-ranging requirements in terms of the supporting analysis and evaluation which have to be provided to ensure a thorough assessment of the transaction. For example, although not directly IRB-related, the Bank has established guidelines to ensure appropriate consideration is given to regulatory issues, social responsibility and environmental impact. This approach controls the extent to which these factors could give rise to risks (such as legal or reputational risk) of relevance to capital requirements under the Bank's ICAAP.

5.9 Use of Collateral and Other Credit Risk Mitigation

SMBCE uses various types of collateral to mitigate credit risk inherent within transactions, including:-

- Financial Collateral – Japanese Government Bonds, Cash and/or eligible guarantees (including Formal Guarantee and Credit Default Swaps ("CDS")) and / or Letters of Credit.
- Fixed charges over cash balances, tangible assets (e.g. aircraft and ships) and property in the form of buildings, plant and machinery.
- Assignments over receivables, ancillary instruments such as insurance policies, shares and share pledges.

It should be noted that in regulatory capital calculations, SMBCE recognises the collateral only if it is categorised as being collateral where the current value is easy to evaluate and is very stable, and there is strong liquidity. This only includes deposits and government bonds. The effect of collateral is recognised by applying supervisory, post hair-cut LGDs on each transaction under the comprehensive method.

5.10 Validation of rating systems

The grading models used are subject to annual validation to ensure that they retain a sufficient degree of default discrimination power and the conservativeness in terms of the accuracy for the regulatory credit risk capital calculation. The independent validation process at SMBCE consists of the quantitative testing and the qualitative testing. Each test has predefined trigger for the necessary actions to take. The performance of the rating models out of the validation work are report to the ARCCo and the Board to give the assurance the Bank to use the models continuously for the regulatory purpose as well as the credit business purpose.

5.11 Securitisation

SMBCE utilises securitisations in order to enhance capital efficiency by freeing up capital, particularly in the area of Project Finance. In securitisations, credit derivatives are used to transfer underlying obligor risk to external counterparties. For the purposes of portfolio management across business units SMBCE securitises pools of lending assets.

Where the securitisation exposures are rated by an eligible External Credit Assessment Institution (“ECAI”) SMBCE uses the Ratings Based Method for calculating regulatory capital requirements. Where these grades are not available SMBCE employs the Supervisory Formula method.

Such structures have formed, and continue to form, an important part of SMBCE’s commercial lending practices, particularly as they relate to Project Finance. Although a niche participant in the securitisation market to date, SMBCE has been one of the most active originators of securitisations referencing a range of project finance lending positions.

SMBCE makes use of both publicly rated and unrated securitisation techniques. Decisions about which approach is adopted will tend to result from prevailing market conditions, operational considerations and the particular requirements of the target group of investors. In calculating its capital requirements under Basel II SMBCE uses both the Ratings-Based Approach (“RBA”) where the securitisation exposures are rated by an eligible ECAI and the Supervisory Formula (“SF”) where external ratings are not available.

List of securitisations SMBCE has originated to date:

Deal Name	Closing	Deal Type	Portfolio Amount	Assets	SMBCE role
Profile I	Dec-05	Synthetic CDO	GBP 383m	UK PFI/PPP project loans	Originator
SMART PFI 2007 GmbH	Mar-07	Synthetic CDO	GBP 400m	UK PFI/PPP project loans	Originator
QVS Funding I Plc	Dec-09	Cash CLO	EUR 520m	Corporate Loans	Originator Investor

With regard to QVS Funding I Plc, SMBCE originated QVS Funding I Plc and purchased all the notes issued (AAA notes and subordinated notes) in order to provide the AAA tranche to the ECB as collateral to support funding. Therefore the purpose of this securitisation is not to transfer underlying obligor risk to external counterparties and there is no change to the existing credit monitoring framework for underlying assets.

6. Market Risk Management

6.1 Market Risk Management

The Bank recognises market risk, as defined in Section 3.2 of this Disclosure Document, as being one of the principal risk categories arising in its activities.

For regulatory capital purposes, the Bank calculates its market risk capital requirements according to the Standardised methodology.

The Bank can demonstrate its quantitative management of market risks through its establishment of appropriate risk tolerances and limits; ensuring the continued transparency of the risk management process; clearly separated front, middle and back office operations and a control system of mutual checks and balances.

6.2 Market Risk Management Framework

The Bank has in place well defined policies and procedures for the identification, measurement and control of market risk. Embedded within these is a framework of management responsibilities.

The Board oversees the market risk management process. The corporate governance framework for market risk management ensures that appropriate controls, policies and senior management oversight form the basis of the Bank's approach to market risk management.

The Board has delegated to the Co-General Managers of Treasury Department ("GMs of TD") the executive responsibility to prudently manage the general market risk of SMBCE within the limits and guidelines established by the Board. These are aligned appropriately with limits and guidance from Corporate Risk Management Department of SMBC.

The Board has also delegated to the General Manager, Risk Management Department, who also acts as the Bank's Chief Risk Officer ("GM of RMD & CRO"), the responsibility for middle office and risk management. RMD is independent of Treasury Department. RMD is therefore responsible for identifying, measuring, monitoring and analysing SMBCE's market risk exposure and reporting to the management of SMBCE.

The principal aspects of the governance and control of market risk are set out in the Market Risk Policy (Interest Rate Risk in the Banking Book) and Market Risk Policy (Trading Book), updated on an annual basis, both of which are key operating policies of the Bank approved by the Board. Key aspects include Market Risk Measurement and Stress Testing.

6.3 Market Risk Management Methods

i) Market Risk Measurement

SMBCE separates market risk related activities between its Banking book and its Trading book. The accounting, risk control and capital (regulatory and economic) for each of these is established to be appropriate to the nature and scale of the activities conducted. The nature of the Banking book is to generate profit through the management of interest rates, terms and other aspects of assets (loans, bonds) and liabilities (deposits etc.) by market operations.

While market risk capital for regulatory capital purposes is calculated according to the Standardised methodology, SMBCE also measures and controls market risk using Value at Risk (VaR). VaR is a measure of the maximum expected loss in a portfolio to a given degree of confidence over a specified period. SMBCE has adopted SMBC's approach to the calculation of VaR and uses a 99% confidence interval and a one-day time horizon. SMBCE currently uses an historical simulation to generate the VaR result using data from a four-year observation period, updated monthly.

The limitations to VaR are well recognised, for example the use of historical data as a guide to future price movements and the assumption that open positions can be hedged within the specified holding period. Therefore the Bank subdivides market risk into key types for which foreign exchange risk and interest rate risk are the main categories. Risk management for each category is fine-tuned by employing suitable sensitivity limits such as foreign exchange exposure and Basis Point Value (BPV) limits. BPV measures the potential change in portfolio fair value for an instantaneous 0.01% rise in interest rates.

Foreign exchange and Interest rate risk (in both banking and trading books) are monitored on a daily basis. Reporting on risk versus limit is submitted to senior management on a same day basis.

ii) Stress Testing

SMBCE prepares interest risk stress tests on a monthly basis consisting of six rate shift scenarios applied to the Banking (and Trading) book positions with a maximum loss scenario reported to management. Foreign exchange stress tests are also conducted on a monthly basis where potential US dollar appreciation and depreciation is applied to the banks open currency positions. A maximum loss scenario is calculated and reported to Management.

In addition to the above stress scenarios further scenarios have been developed drawing on actual observed historic events and/or guidance from regulatory or industry bodies.

Scenarios utilised are revised at least semi-annually.

7. Liquidity Risk Management

7.1 Basic Approach to Liquidity Risk Management

The Bank recognises liquidity risk, as defined in Section 3.2 of this Disclosure Document, as being one of the principal risk categories arising in its activities.

The Bank can demonstrate its quantitative management of liquidity risks through its establishment of appropriate risk tolerances and limits; ensuring the continued transparency of the risk management process; clearly separated front, middle and back office operations and a control system of mutual checks and balances.

7.2 Liquidity Risk Management Framework

The Board is responsible for ensuring that the Bank has a robust and appropriate liquidity risk management framework in place that is well integrated into the firm-wide risk management process.

The key aspects of the framework are reflected in the Bank's Liquidity Risk Policy and Individual Liquidity Adequacy Assessment. These documents are subject to regular review.

The Chief Risk Officer is responsible for reporting matters arising from the Asset and Liability Management Committee to the Executive Committee and Audit, Risk and Compliance Committee. The Chairman of the Asset and Liability Management Committee is responsible for circulating the minutes of those meetings to all SMBCE Executive Committee members and the Co-GMs of the Audit Department.

Market Risk Management Group of RMD (MRMG) is responsible for the identification, measurement and control of liquidity risk and ensures that policies applicable to the management of liquidity risk are clearly stipulated.

The Bank's liquidity risk management framework includes the continued development of proactive and practical risk management policies to adopt market best practice including;

- Quantification and communication of risk;
- Control of the relevant risk limits;
- Ensuring the transparency of risk management;
- Ensuring validity of reports through appropriate checks and comparisons; and
- Accurate and timely risk measurement.

The liquidity risk management framework covers several main areas, including (but not limited to):

- Stress testing and early warning indicators;
- Pricing of liquidity risk;
- Intra-day management of liquidity;
- Contingency funding planning;
- Management of collateral;
- Management of liquidity across legal entities, business lines and currencies; and
- Funding diversification and market access.

Within the overall framework, there is a multi-layer approach indicative of the Bank's conservative bias towards liquidity, including the following elements:

- ensuring access to short-term funding;
- appropriate medium and long term funding strategy; and
- stress testing and contingency funding planning (consisting of four phases based on the funding situation, market conditions, etc).

This approach enables the Bank to manage liquidity risk in a proactive and risk-sensitive manner.

8. Operational Risk Management

8.1 Overview

The Bank has an established Operational Risk management function the purpose of which is to develop, implement and maintain the Bank's Operational Risk strategy and framework to mitigate the risk of losses from inadequate or failed internal processes, people and systems, or from external events.

The Bank's framework for Operational Risk management aims to minimise the occurrence and impact of Operational Risk events, in particular avoiding extreme or catastrophic events, in order to support the Bank's achievement of its strategic objectives.

To achieve this, the Bank has an established Operational Risk management governance structure and framework of processes to:

- ensure an appropriate understanding and awareness of Operational Risk at all levels of the Bank;
- effectively anticipate operational risks and implement appropriate mitigation in line with the Bank's Operational Risk appetite;
- effectively manage Operational Risk events to minimise their reoccurrence;

The Bank's is using the TSA approach for managing Operational Risk, including its regulatory Operational Risk Capital Requirement ("ORCR") under Pillar 1 of Basel II. The Bank's ORCR (TSA) is measured in accordance with BIPRU Chapter 6.4. The Bank divides its activities into a number of business lines: "Trading and Sales" , "Corporate Finance" and "Commercial Banking" in accordance the principles for business line mapping in BIPRU 6.4.10 to 6.4.15.regulatory capital requirements for operational risk are calculated according to The Standardised Approach ("TSA") under which gross income is regarded as a proxy for the Operational Risk exposure within each business line. The capital charge for Operational Risk is calculated based upon gross income for the preceding three years.

The Bank's activities and methodology are closely aligned with those adopted across SMFG globally. Since 31st March 2008, SMBC has adopted the Advanced Measurement Approach ("AMA") for calculation of operational risk capital requirements on a consolidated basis across the group as a whole.

9. Capital Structure

9.1 Overview

All figures in USD 000's

	31 March 2013	31 March 2012
Tier 1 core capital		
Permanent share capital	2,400,000	1,600,000
Profit & Loss and other reserves	206,455	135,200
Intangible assets	(2,924)	(3,400)
Qualified tier 2 capital		
Subordinated debt	800,000	800,000
Deductions from Tier 1 and Tier 2 capital	<u>(2,942)</u>	<u>(3,200)</u>
Total capital after deductions	<u>3,400,589</u>	<u>2,528,600</u>

On 28 May 2013, the Bank repaid and cancelled the USD 800 million Subordinated Loan Note that had been issued to SMBC in May 2008. On the same date, the Bank issued to SMBC 800,000 new Ordinary shares of USD 1,000 each at par value.

9.2 Securitisation first losses

As per PRA BIPRU guidelines (para. 9.10.2) SMBCE has elected to include any first loss positions arising from securitisation transactions as additions to Credit Risk rather than deduct the exposure value from capital resources.

9.3 Expected loss excesses

SMBCE's provisions exceed the Expected Losses on those assets. Therefore, there is no requirement or opportunity to deduct 50% of excesses from capital.

10. Capital Adequacy

10.1 Capital requirements for Credit Risk

All figures in this section USD 000's

	31 March 2013	31 March 2012
Standardised Approach		
Corporate exposures	593,808	614,177
Internal Ratings Based Approach - Foundation		
Central governments and central banks	5,162	2,268
Banks	42,630	70,908
Corporate exposures – excluding specialised lending	89,792	102,742
Corporate exposures – specialised lending	243,127	286,177
Total IRB	380,710	462,095
Total Credit Risk Capital Requirement	974,518	1,076,272

Notes:

1. The Standardised Approach is used for non-Japanese corporate customer exposures and is calculated as credit risk-weighted asset amount x 8%.
2. Foundation IRB Approach is used for all other asset classes, including Specialised Lending via the Supervisory Slotting Criteria. It is calculated as per PRA guidelines using Bank estimates of Probability of Default (PD). The credit risk-weighted asset amount x 8% is then multiplied by a scaling factor of 1.06.
3. Figures include securitisation first losses, as additions to Credit Risk rather than deductions from capital resources.

10.2 Capital requirements for Market Risk

	31 March 2013	31 March 2012
Standardised Method		
Interest rate risk	21,300	15,800
Options transactions	700	300
Foreign Exchange risk	1,800	1,600
	<hr/>	<hr/>
	23,800	17,700
	<hr/> <hr/>	<hr/> <hr/>

10.3 Capital requirements for Operational Risk

	31 March 2013	31 March 2012
The Standardised Approach	54,127	55,382
	<hr/>	<hr/>
	54,127	55,382
	<hr/> <hr/>	<hr/> <hr/>

10.4 Capital Adequacy ratio, Tier 1 capital adequacy ratio and total capital requirement

	31 March 2013	31 March 2012
Total capital adequacy ratio	25.4%	17.4%
Tier 1 capital adequacy ratio	19.4%	11.9%
Total capital requirements	1,072,901	1,149,354
8% of credit risk-weighted assets	994,974	1,091,993
Capital requirements for Market Risk	23,800	17,700
Capital requirement for Operational Risk	54,127	55,382

11. Credit Risk Exposures

11.1 By approach

All figures in this section in USD 000's

	Exposure At Default "EAD"	
	31 March 2013	31 March 2012
Standardised	8,408,800	10,916,916
FIRB	25,283,494	15,520,589
FIRB – Specialised Lending	4,738,484	5,046,198
	<u>38,430,778</u>	<u>31,483,703</u>

11.2 By exposure type

Exposure type	EAD	Specific provisions	EAD	Specific provisions
	31 March 2013		31 March 2012	
Finance and insurance	19,762,774	33,264	13,033,385	45,294
Govt. & local authorities	560,343	0	372,747	0
Manufacturing	2,745,135	22,986	2,727,330	22,607
Wholesale	599,578	0	561,365	0
Services	32,049	0	82,029	0
Other corporate exposures	9,432,270	138,318	8,972,971	93,830
Transport	1,667,892	0	2,109,116	20,904
Energy	1,103,965	0	910,451	0
Infrastructure	2,451,751	0	2,636,234	0
Co-Investment	75,020	0	78,075	0
	<u>38,430,778</u>	<u>194,568</u>	<u>31,483,703</u>	<u>182,635</u>

11.3 By residual maturity

Maturity band	EAD	
	31 March 2013	31 March 2012
To 1 year	22,501,438	15,081,144
More than 1 year to 3 years	3,821,953	3,299,066
More than 3 years to 5 years	4,703,272	5,922,486
More than 5 years to 7 years	1,678,813	1,346,698
More than 7 years	5,725,302	5,834,309
	<u>38,430,778</u>	<u>31,483,703</u>

11.4 By geographic area

Country region	EAD		Specific provisions	
	31 March 2013		31 March 2012	
United Kingdom	15,092,475	41,090	8,689,685	24,802
France	11,666,291	63,342	8,989,135	51,703
Italy	1,120,194	7,109	1,230,396	0
Other Europe	4,426,223	28,885	4,506,385	48,808
Eastern Europe	1,756,400	26,184	2,104,699	29,058
Japan	1,315,528	0	3,228,871	0
Other Asia	394,351	0	162,782	0
Africa	688,094	0	508,667	0
Latin America	7,356	0	23,297	0
Middle East	646,269	27,958	733,178	28,265
North America	1,053,016	0	1,035,779	0
Oceania	264,581	0	270,829	0
	<u>38,430,778</u>	<u>194,568</u>	<u>31,483,703</u>	<u>182,636</u>

11.5 Exposures subject to IRB approach – Corporate exposures

31 March 2013

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
J1 - J2	396,401	52,887	449,288	13.1%
J3 - J4	930,863	467,338	1,398,200	33.2%
J5 - J6	7,923	30,561	38,484	111.7%
J7A - 7B	0	1,523	1,523	139.5%
Others	0	73,235	73,235	18.0%
J7R - J10	0	0	0	
	1,335,187	625,544	1,960,730	

31 March 2012

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
J1 - J2	332,595	63,741	396,336	11.4%
J3 - J4	995,557	561,107	1,556,664	34.0%
J5 - J6	103,417	29,459	132,876	124.8%
J7A - 7B	0	2,337	2,337	175.0%
Others	0	82,755	82,755	22.8%
J7R - J10	0	0	0	
	1,431,569	739,399	2,170,968	

11.6 Exposures subject to IRB approach – Sovereign exposures

31 March 2013

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
G1 - G2	15,846,106	0	15,846,106	0.0%
G3 - G4	36,308	0	36,308	70.2%
G5 - G6	30,000	0	30,000	107.4%
G7A - 7B	0	0	0	0.0%
Others	0	0	0	0.0%
G7R - G10	0	0	0	
	15,912,414	0	15,912,414	

31 March 2012

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
G1 - G2	6,185,007	0	6,185,007	0.0%
G3 - G4	28,202	1,060	29,262	73.2%
G5 - G6	0	0	0	0.0%
G7A - 7B	0	0	0	0.0%
Others	0	0	0	0.0%
G7R - G10	0	0	0	
	6,213,209	1,060	6,214,269	

11.7 Exposures subject to IRB approach – Bank exposures

31 March 2013

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
J1 - J2	491,467	77,789	569,256	4.8%
J3 - J4	15,000	37,911	52,911	26.2%
J5 - J6	0	0	0	0.0%
J7A - 7B	0	0	0	0.0%
Others	0	146,124	146,124	27.4%
J7R - J10	0	0	0	
	506,467	261,824	768,291	

31 March 2012

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
J1 - J2	419,074	118,333	537,407	4.8%
J3 - J4	45,000	23,153	68,153	18.4%
J5 - J6	0	0	0	0.0%
J7A - 7B	0	0	0	0.0%
Others	0	9,718	9,718	27.4%
J7R - J10	0	0	0	
	464,074	151,204	615,278	

11.7 Exposures subject to IRB approach – Bank exposures – cont.

31 March 2013

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
G1 - G2	1,585,212	651,350	2,236,562	14.6%
G3 - G4	259,954	35,856	259,810	56.0%
G5 - G6	59,716	29,918	89,635	42.0%
G7A - 7B	0	0	0	0.0%
Others	0	0	0	
G7R - G10	0	0	0	
	<u>1,904,882</u>	<u>717,124</u>	<u>2,622,007</u>	

31 March 2012

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
G1 - G2	3,978,351	908,367	4,886,718	12.2%
G3 - G4	411,468	39,402	450,870	61.4%
G5 - G6	60,288	9,019	69,306	59.3%
G7A - 7B	0	0	0	0.0%
Others	0	0	0	
G7R - G10	0	0	0	
	<u>4,450,107</u>	<u>956,788</u>	<u>5,406,894</u>	

11.8 Exposures subject to IRB approach – All exposures

31 March 2013

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
J1 - J2	887,868	130,676	1,018,544	8.5%
J3 - J4	945,863	505,249	1,451,112	32.9%
J5 - J6	7,923	30,561	38,484	111.7%
J7A - 7B	0	1,523	1,523	139.5%
Others	0	232,108	232,108	24.2%
J7R - J10	0	0	0	
	1,841,654	900,117	2,741,771	

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
G1 - G2	19,514,919	2,021,149	21,536,068	2.5%
G3 - G4	424,607	231,605	656,212	46.9%
G5 - G6	196,242	30,310	226,552	80.1%
G7A - 7B	47,282	0	47,282	248.9%
Others	0	0	0	0.0%
G7R - G10	63,828	0	63,828	100.1%
	20,246,878	2,221,353	22,468,232	

Co-investment	9,564	1,656	11,220	80.0%
Total	22,088,532	3,123,126	25,221,223	

11.8 Exposures subject to IRB approach – All exposures – cont.

31 March 2012

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
J1 - J2	751,669	196,651	948,319	7.5%
J3 - J4	1,040,557	584,260	1,642,818	33.3%
J5 - J6	103,417	29,459	132,876	124.7%
J7A - 7B	0	2,337	2,337	175.0%
Others	0	92,472	92,472	23.3%
J7R - J10	0	0	0	
	1,859,643	905,179	2,800,882	

Grade	EAD			Average risk-weight
	On balance sheet	Off balance sheet	Total	
G1 - G2	10,770,772	1,142,246	11,913,018	6.5%
G3 - G4	501,942	56,489	558,431	60.6%
G5 - G6	133,345	9,019	142,364	100.6%
G7A - 7B	54,356	520	54,875	253.4%
Others	0	0	0	0.0%
G7R - G10	40,065	0	40,065	
	11,500,480	1,208,274	12,708,753	

Co-investment	5,405	5,905	11,012	80.0%
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Total	13,365,528	2,119,358	15,520,647	
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11.9 Specialised lending by exposure and weighting

Slotting Criteria	Risk-weight	EAD	
		31 March 2013	31 March 2012
Strong	50% 70%	4,105,721	4,173,666
Good	70% 90%	350,468	397,065
Satisfactory	115%	121,546	204,938
Weak	250%	111,367	217,148
		<u>4,689,101</u>	<u>4,992,817</u>

Other assets under EL methodology

Co-investment transactions	49,382	53,381
Total EL method	<u>4,738,484</u>	<u>5,046,198</u>

11.10 Standardised Approach by risk weighting

CQS	S&P ratings	Weight	EAD	
			31 March 2013	31 March 2012
1	AAA to AA-	20.0%	65,791	61,580
2	A+ to A-	50.0%	953,234	1,897,917
3	BBB+ to BBB-	100.0%	1,395,693	1,486,032
4	BB+ to BB-	100.0%	84,010	148,226
5	B+ to B-	150.0%	55,228	62,049
6	CCC+ and below	150.0%	0	0
No ECAI grade ¹		20.0%	0	0
		50.0%	36,012	48,171
		100.0%	5,706,522	6,635,627
LFG ²		150.0%	112,311	577,315
			<u>8,408,800</u>	<u>10,916,917</u>

¹ Default weight depends on exposure class for all transactions without an external grade from an approved ECAI. All SMBCE Standardised Approach assets are corporates.

² Leveraged Finance Group (LFG) assets default to 100% but an internal adjustment is made to assume that CQS5 @ 150% would be applied if external grade were found.