Telephone conference on Financial Results for 1HFY2024 (November 12, 2024)
Questions and Answers

(Respondent: Masaya Yamashiro, Executive Officer of SuMi TRUST Group)

Q.1	Could you explain the background to the share repurchase announced today, including the size and timing? I would also like to check if there is any change in your approach to prioritizing capital efficiency?
A.1	Today, we announced a share repurchase of up to 30 billion yen. We conducted a share repurchase of 30 billion yen in FY2021, which we consider to be a relatively significant amount. As for capital utilization, we will implement appropriate options (investment and shareholder return) based on capital adequacy and business progress. The CET1 ratio was 10.9% at the end of September 2024, which is a relatively high level for a snapshot. The main reasons for the increase in the ratio were the impact of foreign exchange rates and the fact that RWA did not increase as much as expected as we carefully reviewed lending projects based on capital efficiency. Another reason was that we considered investment projects in detail and ultimately did not implement them, giving priority to the disciplines of capital efficiency and price adequacy. The decision for the current 30 billion yen share repurchase was made in light of the current level of the CET1 ratio, the confirmation that our business is moving in the direction of stable growth with capital light, and the need to adjust the level of capital in pursuit of capital efficiency. Going forward, we will carefully consider investments that contribute to earnings growth. However, improving ROE remains critical, so we will also consider returns from a capital efficiency perspective and determine the optimal amount for share repurchases as needed.

Q.2	Could you explain whether the decision to repurchase shares was influenced by the fact that the reduction of strategic shareholdings is progressing well and that fee income is increasing due to an increase in assets under management/custody? In the context of the increasing likelihood of future earnings, is it possible to deploy capital in such a way that the level of capital could be temporarily reduced if there is an opportunity for growth?
A.2	We have seen an increase in fee income and efficient use of our balance sheet, improving our stable earnings power. While not directly related to the share repurchase, increased earnings stability contributes to stronger shareholder returns. On the other hand, the reduction of strategic shareholdings is somewhat different. From a capital management perspective, we manage our CET1 ratio including OCI, and the unrealized gains on strategic shareholdings are already included in capital. If we reduce strategic holdings, 40% of the gains on sale, which is our dividend payout ratio, will result in an outflow of capital. In other words, the impact on capital depends on whether the gains come from regular business activities, as reflected in net business profit before credit costs, or from net gains on stocks. In terms of how much of a decline in the CET1 ratio is acceptable, it depends on what kind of investment projects are available. While we can expect gains from the sale of strategic shareholdings in the coming years, it is also necessary to invest for sustainable growth. If there are opportunities to invest in ways that will increase ROE in the medium to long term, we will seize them. When considering individual investment projects, we will adhere to investment discipline, including price appropriateness.

Q.3	Could you explain your approach to the target range for the CET1 ratio? Even with the 30 billion yen share repurchase, the CET1 ratio will be around 10.7%, which seems to provide a substantial buffer for market fluctuations and growth investments. Is the direction for the CET1 ratio, including unrealized gains on stocks, to maintain between 10% and the mid-10% range?
A.3	Our target for the CET1 ratio has been "stably maintain 10% or above", and this remains unchanged. At the end of September, the ratio was 10.9%. With the 30 billion yen share repurchase, it will be reduced to around 10.7%. Taking into account exchange rate fluctuations (depreciation of the yen) since the end of September, we estimate the current ratio to be approximately 10.6%. In addition, substantial growth investments could further reduce the ratio by about 0.3%. Depending on the environment and investments affecting RWA, the ratio could fall below 10%. While it may not always remain within this range, our aim is to maintain it stably 10% or above.

Q.4	The pace of reducing strategic shareholdings has been quite rapid, with an annual pace of 75 billion yen (at cost). From FY2025 onwards, negotiations for reductions may become more challenging, which may slow the pace. Is this view correct, or will the pace not slow?
A.4	We have made significant progress in reducing strategic shareholdings. At the end of September, the market value of our holdings was 1.057 trillion yen in the bank account and 367 billion yen in the retirement trust (so-called deemed shares), for a total of approximately 1.425 trillion yen. As shown on page 13, this represents approximately 47% of total net assets at the end of September 2024. We aim to sell three-fifths of this amount over the next four and a half years, reducing the ratio to approximately 20%. Depending on the corporate governance situation of our client companies, there have been cases where they have suddenly agreed to sell. While it is becoming increasingly difficult to reduce at the same pace each year, there is a possibility that the pace of reduction may not remain constant. However, we have stated our goal of reducing strategic shareholdings to zero and intend to maintain the current pace of reduction.

Q.5	Regarding the reduction of strategic shareholdings, is there a possibility that the pace of reduction may be skewed toward either the bank account holdings or the deemed shares? I understand that in the case of deemed shares, there is no financial accounting profit on the sale. In addition, is there any change in the policy for reducing bear funds?
A.5	There is no difference in the way we approach the reduction of shares held in bank accounts and deemed shares. However, if the shares of certain client companies whose shares we sell significantly are concentrated in one category, the pace of reduction may differ from category to category. As of the end of September 2024, the valuation loss on bear funds is approximately 40 billion yen. We will continue to reduce bear funds in line with the reduction of strategic shareholdings. Depending on the progress of the reduction of strategic shareholdings, we anticipate that the balance of bear funds may be significantly reduced as early as the next fiscal year.

Q.6	Could you explain the changes in the estimates of the impact of the Japanese interest rate hike on earnings from the previous one?
A.6	We revised the impact for FY2024 compared with FY2023 from over 15 billion yen to over 20 billion yen, taking into account the July rate hike. In addition, for the estimate of an additional rate hike, we have revised the assumption to a 25bp increase, resulting in an impact of over 15 billion yen. Previously, the sensitivity to a 10bp rate hike was around 8 billion yen, but the current estimate is around 6 billion yen. We have reviewed the deposit beta based on actual results. The main point is that when the policy rate increased by 15bp, ordinary deposits increased by 8bp, so we revised the deposit beta from about 40% to about 50%. We understand that other companies had a similar deposit beta. Another point to note is that this estimate is based on deposit beta and focuses on a narrow impact, mainly from deposits on net interest income. In reality, the ALM position due to our unique long-term fixed deposits has unrealized gains that will materialize over 3-4 years, and these gains increase as interest rates rise. In addition, while credit spread widening could also be considered an interest rate impact, it is not included in the calculation.

Q.7	You explained that the net business profit before credit costs was only 50% of the target due to the poor performance of the Global Markets Business. What were the factors behind this poor performance? Can it be recovered in the second half of the fiscal year?
A.7	Global Markets includes client-related businesses such as marketing, market making and asset and liability management (ALM), as well as investment activities. Investment was the main driver of the year-on-year decline in revenues. This was mainly due to negative revenues from derivatives related to US interest rates, particularly in the rising rate environment. As this is an investment business, we do not see this as a structural or continuous decline in profits. Global Markets Business is also repositioning its portfolio.

Q.8	The CET1 ratio increased by 0.7% this term to 10.9% at the end of September. What were the factors behind this increase improvement? You have explained that this was due to strict credit management that prevented an increase in RWA, but what other factors were involved? In addition, to what extent can we expect strict management of credit profitability to continue in the future? As you replace corporate lending with product-related credit, is it correct to understand that the reduction was ahead at the end of September?
A.8	The factors behind the increase in the CET1 ratio were a 0.2% decrease due to dividends, a 0.5% increase due to retained earnings, a 0.2% increase due to the appreciation of the yen, and a 0.2% increase due to the advancement of RWA suppression through a focus on credit profitability. Together, these factors resulted in a total increase of approximately 0.7%. We have mentioned that we will shift from corporate lending to product-related credit. We reduced corporate lending in the first half of the year. It is a challenge to increase product-related lending by the same amount at the same time. As you understand, it is a question of timing. In the second half of the year, we will take advantage of opportunities for product-related lending, which can also be used to strengthen the asset management and asset administration businesses. In addition, we have improved spreads in both corporate and product-related lending, with spreads improving by 5-10bp compared to a year ago.

Q.9	You mentioned that the profit targets of the Medium-Term Management Plan are expected to be achieved one year ahead of schedule. Given the changes in the business environment since the plan was formulated, could you explain the positive and negative factors for each segment?
A.9	When we formulated the Medium-Term Management Plan, we did not anticipate the current inflation, rising interest rates, and yen depreciation. We view these changes in the business environment as overall positive for our business. Regarding each segment, the Wealth Management Business has benefited from the expansion of deposit income due to rising yen interest rates and the favorable performance of investment management consulting following the introduction of the new NISA. The Corporate Business has seen improvements in deposit and loan spreads due to rising interest rates, and the strategic shift from corporate lending to product-related lending has resulted in better than expected credit-related fees. In the Investor Services Business, products related to private assets are gaining traction, particularly with financial institutions and pension funds, and the increase in market values has positively impacted our asset management and asset administration businesses. The Real Estate Business has observed a trend among business clients to reassess their assets to enhance capital and asset efficiency, driven by strengthened corporate governance. Additionally, overseas investors are returning, increasing transaction demand. The Global Markets Business has benefited from increased market volatility in client-related operations, although rising interest rates tend to destabilize revenues in investment operations. Regarding negative factors, there are currently no significant concerns, including credit risk.

Q.10	Could you explain your outlook for second-half profits and the possibility of raising the full-year target? While net business profit before credit costs for the first half was in line with expectations, there seems to be potential for additional gains from rising yen interest rates and net gains on stocks due to the reduction of strategic shareholdings.
A.10	Net business profit before credit costs for the first half of the year was 50% of the target for this year, which was brought forward by one year from the target for fiscal 2025 when the Medium-Term Management Plan was formulated. Client-related businesses, asset management, and real estate businesses increased profits. We are achieving profit growth in line with our aspiration for a virtuous circulation in the capital markets. If the current environment continues, we can expect broad-based earnings growth. With appropriate risk control, the Global Markets Business can also target an increase in net business profit before credit costs. In terms of net gains on stocks, if we aim to achieve the target of 150 billion yen (at cost), it would be necessary to sell 41.3 billion yen (at cost). Depending on the level of the stock market and the specific stocks sold, there is a possibility that we will exceed the projected sales as the reduction progresses.

Q.11	If the full-year net income attributable to parent company shareholders is revised upward, will the dividend payout ratio of 40% be considered excluding the commemorative dividend?
A.11	Your understanding is indeed correct.

Q.12	In terms of credit costs, while there have been reversals of general loan loss provisions, it appears that there have also been reclassifications, such as an increase in specific loan loss provisions. If there had been no reversals of general loan loss provisions, it seems that credit costs would have been slightly higher. Could you give us your outlook on that?
A.12	There have been utilizations of special provisions and reclassifications of debtor categories. While there have been individual cases regarding the status of our clients, there is no general trend of deterioration. We believe that total credit costs can be managed within our forecast in FY2024.