

Investor Meeting on Financial Results for 1H FY2019 (Nov. 20, 2019) Questions and Answers

Q1.	Regarding the president's awareness of issues ahead of your next Midterm Management Plan. What are the key themes that are being discussed internally? Given the tough business environment, what are the strategic directions you are considering for the medium to long term?
A1.	<p>We are currently developing our next Midterm Management Plan, based on an assumption that the negative interest rate environment will persist for a while and thus that traditional commercial banking business will continue to face challenging conditions.</p> <p>In terms of our strategic direction, how we grow our fee businesses will be key. Since generating profits in the order of ¥5-10 billion with just one business in the short term will prove difficult, diversifying our sources of earnings will be required. For example, our stock transfer agency services business has developed into a business that could potentially aim to generate ¥3.0 billion in annual gross profits owing to our efforts in reinforcing our high value-added corporate governance consulting capabilities. To what extent we can nurture such new kinds of businesses will be key, in our view.</p> <p>Cost control in tandem with strengthening our fee businesses will be crucial. While we intend to make strategic system investments such as for example, shifting to a cloud-based environment, we must also solidly work on total cost management that includes personnel as well as non-personnel costs other than system costs.</p>
Q2.	Fees in financial businesses continue to be under downwards pressure or pressure to offer services free of charge. How do you plan to maintain profitability of your fee businesses? In particular, since you have higher dependency on your fee businesses, what strategies do you intend to employ and what does the organizational structure you need to build look like?
A2.	<p>There certainly is downward pressure on fees. Responding with differentiated services driven by added value would be the model answer, but such an approach does not necessarily go as well as hoped.</p> <p>Therefore, how we increase the number of clients and the amount of their assets under management will be key. We also intend to achieve sustained, stable growth in fee income by growing recurring fee income, rather than upfront fees.</p>

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Q3.	<p>Regarding your capital policy on page 43. Your CET1 ratio, based on finalized Basel standards, was (tentatively calculated to be) in the higher 9% levels as of September end 2019, steadily building up towards your target of about 10% levels. Within such context, what does the direction of your policy on shareholder returns going forward look like? With your dividend payout ratio slightly lagging that of megabanks, how do you intend to strike a balance between dividends and share buybacks?</p> <p>Also, do you have any updates on investments for growth?</p>
A3.	<p>We will continue to seek the right balance across growth, efficiency, and shareholder returns in our capital policy. Our overarching approach of steadily enhancing shareholder returns also remains unchanged. We are aware of the gap between our dividend payout ratio and that of the megabanks and are also under the impression that many investors place more importance on the dividend payout ratio when considering the balance between dividend and share buyback. In light of these facts, along with reference to our target of steadily maintaining our CET1 ratio at 10%, we will continue to examine our shareholder return policy in step with the formulation of our next Midterm Management Plan.</p> <p>The direction of our investments for growth remains largely unchanged, centering on asset management and asset administration areas. That said, compared with 1–2 years ago, it is increasingly difficult to envisage acquiring an asset management company in full. We will, for the time being, look to expand and strengthen our asset management business network mainly through business and capital alliances.</p>

Q4.	<p>I would like to hear more about your wealth management business with UBS. Statistically, Japan has a large affluent population, and your collaboration in this market with UBS where you have no overlap in terms of clients and functions, I think is ideal.</p> <p>However, reflecting on past examples of the affluent businesses in Japan, there are hardly any success stories. Will you be able to succeed different from past failed examples? And what kind of growth story are you and UBS picturing?</p> <p>Also, is there a chance that you may work with UBS in areas other than wealth management in the future?</p>
A4.	<p>There has been no “the sure way to go” wealth management business in Japan to date which makes it even more worthy of taking on the challenge.</p> <p>UBS boasts the largest wealth management business in the world and also has a substantial client base in Japan. And we, on the other hand offer services that meet the far-reaching needs of affluent clients.</p> <p style="text-align: right;">(continued on the following page)</p>

	<p>As for areas of strengths, we excel in areas such as loans and real estate, while UBS has expertise in handling company owners' treasury stock and assets. By combining our respective strengths, we can add value to our comprehensive service offerings in the wealth management business and believe this will lead to realizing Japan's "first" success story in this field. At this point in time, we have no plans to collaborate with UBS in other areas.</p>
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Q5.	<p>Regarding the competitive environment in the trust business. Regional financial institutions are themselves starting to enter the trust business area. How do you intend to establish your so-called win-win relationships? Are you not concerned that in the medium to long term, regional financial institutions will acquire enough know-how to compete against you?</p>
A5.	<p>We have very few branches outside of Japan's big three cities and think there is potential for us to offer trust services in those regions.</p> <p>Further, instead of us becoming a competitor by dealing with regional financial institutions' clients directly, collaboration with the financial institutions should be possible with us offering outsourcing services in various administrative work areas related to trust operations to them.</p>

Q6.	<p>Regarding risk asset control, your CET1 ratio has improved owing to a more sophisticated method for the appraisal of certain assets. Which assets have you applied this methodology to? And is there room for further improvements?</p>
A6.	<p>As for our current risk asset control, we applied the advanced calculation method to project financing. That reduced our credit risk assets by roughly ¥650 billion from March end which accounts for most of the improvements observed.</p> <p>Our CET1 ratio improved by approximately 0.5% compared to March end on a finalized basis after factoring in the finalization of Basel capital requirements for market risk calculations.</p> <p>While there is not much room for revising our calculations based on finalized Basel standards, there is still room for applying advanced calculation methodology in areas that are entrusted to local authorities to decide. But we are not expecting much impact from this.</p>

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Q7.	Regarding the deployment of surplus foreign currency funds, the environment surrounding US interest rate and cross-currency basis markets is changing. What is your outlook for these markets?
A7.	Our foreign currency surplus investments contributed to increasing profitability in the first half but such transactions are, in a sense, opportunistic earnings initiatives and its results are determined by a balance across the interest rate environment, cross-currency basis markets, and our foreign currency funding environment. Gross profit before funding costs appears quite large, but net profit less funding costs was around ¥8.0 billion. This equates to a year-on-year contribution of about ¥3.2 billion. However, we have no plans at this juncture to further boost earnings from these transactions in the future.

Q8.	The inverted US interest rate yield curve is starting to return to normal. What is the direction of your US Treasuries investments from here? Will you aim to benefit from carry or capital gains?
A8.	Up until fiscal 2016, we focused on the inverse correlation between US Treasuries and Japanese stocks and held a large amount of US Treasuries to hedge against share price risk. However, with the changing market environment, this inverse correlation between Japanese stocks and US interest rates started deteriorating. Therefore, we switched to directly hedging our strategic shareholdings portfolio with bear-type equity investment trusts and started reducing our US Treasuries holdings from two and a half years ago. We have no plans to build up our US Treasuries holdings to benefit from carry going forward. Our investment management policy will focus on controlling US interest rate risk.

Q9.	I understand your approach in the retail business to meticulously meet the diversifying needs of each client generation, but do you have KPIs to measure “to what extent you are meeting these needs and how much room there is for improvement” as you push ahead with this initiative?
A9.	Our most important KPI would be the one that indicates “how many new clients we have gained”. Further, since we offer a wide range of services as a trust bank, KPI that shows “the number of different service types we are offering per client will also be important. Also, from the viewpoint of providing services centered on asset administration, “the volume of client assets we have been entrusted with” will be another important KPI. Along with these three KPIs, knowing whether “client assets are being circulated across different generations” will also be important, even though this may be difficult to quantify as figures. (continued on the following page)

	For example, after a will is executed on an inheritance, we need to monitor whether we have been able to link this to new businesses with the next generation that inherited the assets.
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Q10.	I would like to ask again about the direction of your next Midterm Management Plan. I think the message of your current midterm plan was easily communicated as one that started by “cutting your losses on US Treasuries and targeting a V-shaped recovery over a three-year period”. But for the next three years, you explained six months ago that it is highly likely that net profit growth will be mild due to slower pace of topline growth and higher costs from upfront investments such as those for moving to a cloud environment. While other companies are propagandizing more dividends, what will be your message to investors on the next three years?
A10.	We think the source of earnings, namely, growing profit by offering services that address client needs as well as changes to social structures will be key. In other words, whether we can create a growth curve showing future potential of continuing growth with our engagement in offering businesses that meet the needs of the society will be important. In terms of the quality of earnings, we hope to deliver stability and sustainability, which is why it is key that we steadily accumulate sustained revenue from recurring sources as opposed to upfront revenue. Although sharp profit growth will likely be difficult over the next three years, we will naturally aim to achieve growth to the extent possible. At the same time, we must closely control costs for moving to a cloud-based environment. That said, it is also crucial that we make upfront investments in new businesses like the digitalization of inheritance and real estate services in order to properly establish new sources of income up ahead. And even though it may be a challenging environment for achieving profit growth, we are naturally conscious of our total payout ratio to investors.

Q11.	Despite being in the midst of a harsh environment for your retail fee businesses, you appear to have increased net interest income by controlling your deposit costs, and (when looking at things by business lines) earnings in your wholesale business seemingly drove profit growth. However, with increasingly little room for improvement in deposit costs up ahead, what will be the driver of net interest income? And what will drive profit growth in the wholesale business area?
A11.	In wholesale lending, our net interest income has room for improvement owing to improved spread resulting from our continuing shift toward product loans. This shift is also contributing to earnings growth in our wholesale business with increased profitability in our non-interest income. (continued on the following page)

	<p>More specifically, this growth in non-interest income is coming from long-term forex and derivative transactions linked to renewable energy-related project financings.</p> <p>We will continue to strengthen our fee businesses as a source for driving growth. While we expect DC and savings-type investment trust AUM to increase over the long term, we see little prospect for sales commissions to act as a profit growth driver. Lower sales of investment trust consulting and other factors will place downward pressure on earnings. Still, we will aim to create an earnings base by increasing the number of clients and though it may take some time, also work on reinforcing our asset custodian type of services that comprehensively manage senior clients' assets.</p>
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Q12.	<p>I would like to ask about your asset succession and inheritance related services on page 25. It is important that you string the current client base to acquiring younger next generation clients. And this is likely an area that will surely grow with increasing demand for inheritance services.</p> <p>In light of this, do you think direct earnings in your inheritance related services business will grow further as the size of the market expands?</p>
A12.	<p>We think direct earnings from inheritance-related services will increase. Japan's demographics suggest that the number of inheritances will likely grow up ahead and interest in inheritance matters and procedures is also growing due in part to revisions to the Inheritance Tax Act. We expect the currently around ¥4.0 billion in annual earnings from this business will continue to grow.</p> <p>Moreover, measures for addressing dementia prior to inheritance are also gaining attention as a social issue and we have product offerings to help address the problem of people being unable to use their assets once dementia sets in.</p> <p>Our will trust services offer more than just the signing of a contract—it acts as the starting point for us to provide various types of consulting services related to inheritance matters, such as how the way to hold or manage the assets should be changed which occasionally lead to us making property proposals.</p> <p>Our sample survey has indicated that we are also seeing a considerable increase in transactions with the next generation; in other words, those that inherited the assets after the execution of a will. Therefore, we believe there to be opportunities for us to offer various services to clients including the generation inheriting assets through inheritance consulting rather than just securing direct revenue from inheritance services.</p>

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Q13.	Providing that your alliance with UBS goes well, do you expect earnings contributions to be strong enough to drive the retail business in the future?
A13.	<p>We are currently assessing the numbers to understand the potential contribution to earnings that can be made from this alliance with UBS.</p> <p>We expect to carve out the UBS wealth management business to form a joint venture brokerage firm in about two years' time.</p> <p>The marketing joint venture company that has been mentioned before will be positioned as a run-up scheme until then. We intend to draw up a final business plan based on how many products we sold to how many clients during this lead-up time.</p> <p>We are not anticipating that earnings will be more than one third of our current retail business earnings at this juncture. However, even if earnings contributions may be minimal in the outset, it carries the potential of ultimately growing into a ¥10.0 billion level business.</p>

Q14.	Regarding asset management and administration support to regional financial institutions on page 16. Though I think this is a really good initiative, have you actually made progress on closing contracts? If not, what are the issues at hand?
A14.	<p>Though specific names cannot be mentioned, we are already starting to provide support to regional financial institutions and are also engaged in in-depth discussions with multiple entities on possibly offering our services to them as well.</p> <p>However, owing to the fact that we are providing comprehensive services with limited capacity on our end, we cannot simply expand this offering to 20-30 banks at once. In addition to this, since we cannot afford to sacrifice the quality level of this offering, we will only grow the counterparty base within an addressable scope.</p>

Q15.	ESG and SDGs initiatives are a long-term effort and the capital costs required tend to be high while expected returns are thought to be low. Don't you think the pursuit of these initiatives will ultimately weigh on the company's overall profitability?
A15.	<p>Yes, it is quite difficult to find ways to justify ESG and SDGs initiatives from an earnings perspective. However, compared to roughly 1–2 years ago when we were asked the same question, we now feel there is higher probability of ESG and SDGs initiatives turning into a viable revenue generating business and at the same time also feel that we must engage in these initiatives with a longer horizon in mind.</p> <p>Simply making donations or such may improve our reputation to some extent. But we want to instead aim to commercialize these initiatives and contribute to materializing a sustainable society.</p> <p style="text-align: right;">(continued on the following page)</p>

	<p>Interest from our business counterparts is also on the rise—for example, when we announced our positive impact finance initiative in March this year, we received inquiries from other client companies. These kind of initiatives will not last long unless companies work together as business partners.</p> <p>As observed from some media reports saying that the global balance of SDG- and ESGs-focused investment products are more than ¥3,000 trillion, investors are showing interest and companies, too are taking steps to be selected as the target of such investments. With all of these developments, we feel that a platform for a viable business in this area is starting to be built. SuMi Trust is also addressing five key topics in this space and as mentioned earlier, there is a strong affinity between trust bank businesses and sustainability initiatives. Therefore, we strongly hope to develop a robust business model in this area.</p>
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Forward-Looking Statements

This document contains statements about future earnings.

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