

Sumitomo Mitsui Banking Corporation

**Sumitomo Mitsui Banking Corporation Issued Administrative Orders**  
**By the Financial Services Agency**

Tokyo, April 27, 2006 --- Sumitomo Mitsui Banking Corporation (SMBC; President: Masayuki Oku) announced today that it was issued administrative orders (Business Suspension Order and Business Improvement Order) in respect to the manner in which it marketed interest rate swaps at its Corporate Business Offices, by the Financial Services Agency of Japan (FSA), pursuant to Article 26 (1) of the Banking Law. We deeply regret this situation and sincerely apologize for causing concern to our customers and other stakeholders.

Specifics of the administrative orders are described below. We are responding to the administrative actions of the FSA with profound gravity, and will strictly enforce compliance measures, review Corporate Business Offices' framework for marketing interest rate swaps, and take other measures to prevent reoccurrence. At the same time, we will make every effort to regain the trust of our customers, SMFG (Sumitomo Mitsui Financial Group, Inc., holding company of SMBC) shareholders and the public.

**1. Description of, and Reasons for, the Administrative Orders**

**(1) Description of the Administrative Orders**

**A. Business Suspension Order**

- 1) Corporate Business Offices must be suspended from engaging in marketing (including making proposals and soliciting business) of interest rate derivatives (including embedded products) from May 15, 2006 (Monday) to November 14, 2006 (Tuesday) (excluding cases of manifestation of rational and voluntary intention to purchase such products by existing customers and if recognized as such in an objective manner).
- 2) A Corporate Business Office must not be newly opened from May 15, 2006 (Monday) to May 14, 2007 (Monday).

**B. Business Improvement Order**

- 1) SMBC is required to establish a business administration framework, an

internal control framework and a compliance framework from the following perspectives to ensure proper marketing of financial products as a bank and realize a customer-centric business framework.

- a. To clarify management stance on establishing a customer-centric business framework and a compliance framework
- b. To establish a framework for Corporate Business Offices to properly explain matters to customers and measures for its strict observance (including measures for establishing a framework for head-office supervision and administration)
- c. To establish a compliance framework by strengthening the mutual checking function of each Corporate Business Office (including a review of the “autonomy function” of self-responsibility which is a part of the basic structure of SMBC’s compliance system)
- d. To improve process of establishing business plans and business promotion guidelines to ensure a customer-centric business framework, and proper business administration and management in accordance with laws and regulations
- e. To review the head office’s framework and methods for auditing Corporate Business Offices and the head office, and strictly and thoroughly execute audits, and implement and strengthen follow-ups thereafter, in order to ensure a customer-centric business framework, and proper business administration and management in accordance with laws and regulations
- f. To establish a framework for providing customers with an explanation on individual cases, including responding to complaints and inquiries (including responding to customers who were subjected to the abuse)
- g. To take proper measures to ensure the appropriateness of financial transactions and marketing of financial products and services in accordance with the “Request of Efforts by Financial Institutions to Ensure Appropriateness of their Transactions” issued by the FSA on January 5, 2006
- h. To ensure establishment of the above frameworks through the administrative function of the holding company

- i. To establish a compliance framework that secures the head office's objectivity while strengthening its mutual checking function
- 2) SMBC is required to clearly specify the executives and employees responsible for causing the problems that led to the business suspension order and business improvement order (including the clarification of responsibilities when the violations occurred)
- 3) SMBC is required to submit a business improvement plan with respect to 1) and 2) above by June 2, 2006 (Friday) and implement it immediately
- 4) After implementing 3) above, SMBC is required to summarize the progress, implementation and improvement status of the business improvement plan on a quarterly basis and report it to the FSA no later than the fifteenth day of the following month until the plan is carried out to the end, with the first reporting date to be August 31, 2006

## **(2) The Law on which the Administrative Orders are Based**

Article 26 (1) of the Banking Law

## **(3) Reasons for the Administrative Orders**

- A. SMBC was issued a cease and desist order from the Fair Trade Commission of Japan (“JFTC”) for violation of Section 19 of the Antimonopoly Act (Abuse of Dominant Bargaining Position) on four occasions with respect to marketing of interest rate swaps during the years from 2002 to 2004.
- B. An internal investigation by SMBC confirmed to no small extent cases of abuse of dominant bargaining position (including questionable cases) in marketing of products centered on interest rate swaps from fiscal 2001 to fiscal 2004, in addition to the cases cited by the JFTC. Further, there were numerous questionable cases of fulfillment of legal responsibilities, including “Duty of Financial Product Provider, etc. to Explain” under the Law on Sales of Financial Products.

The investigation found that while constantly focusing on profits, business administration, internal control, and compliance frameworks were inadequate from the perspective of ensuring proper transactions, etc., and the violations were caused by the following major problems. Further, the investigation concluded that it would take a considerable time to bring about major improvements, including a

mindset reform.

- a. With respect to the business plan established annually by the head office, Corporate Business Offices were assigned profit targets without sufficient analyses of local circumstances and past performances. Corporate Business Offices were inclined to market interest rate swaps to achieve the targets.
  - b. The head office's supervision of the Corporate Business Offices were centered on monitoring their progress in achieving their targets, and amid a situation of gross banking profit increasing in the term-end month, the head office failed to sufficiently control excessive promotion of interest rate swaps, of which revenues are recognized up-front.
  - c. Sufficient consideration was not given to preventing abuse of dominant bargaining position when establishing interest rate swap marketing rules.
  - d. There was insufficient checking of business plan and business promotion by each Corporate Business Office in terms of "autonomy function" under self-responsibility of the compliance system.
  - e. The head office did not sufficiently perform its monitoring function, such as analyzing complaints.
  - f. Auditing of Corporate Business Offices did not include sufficient examination of interest rate swap marketing situation, nor did auditing of the head office include prevention of abuse of dominant marketing position.
- C. SMBC failed to take effective measures to comply with the Antimonopoly Act, even though the JFTC and FSA had been sounding warning bells as the financial industry's circumstances changed.

## **2. Summary of Internal Investigation Conducted by a Special Investigation Committee of SMBC**

Last December, SMBC was issued a cease and desist order by the JFTC pursuant to the Antimonopoly Act with respect to cases of abuse of dominant bargaining position by certain Corporate Business Offices in marketing interest rate swaps.

In response, SMBC decided to conduct self inspection and established a special investigation committee which included a third-party, a lawyer who had not entered into an advisory agreement with SMBC, and conducted a rigorous investigation of the situation last December.

The results of the investigation are outlined in the attached report.

### **3. Measures to Prevent Reoccurrence**

In order to prevent reoccurrence and thoroughly reinforce customer-centric and compliance in our minds, SMBC will establish a business improvement plan to greatly revise the frameworks for business promotion, business administration, etc. Specifically, measures will be implemented to prevent reoccurrence from the following perspectives.

#### **(1) Strengthen Compliance with the Antimonopoly Act**

- 1) Review compliance rules related to the Act
- 2) Clarify compliance points of head office's policies related to the Act
- 3) Implement monitoring of compliance status with the Act with respect to business activities

#### **(2) Review Interest Rate Swap Marketing Framework of Corporate Business Offices**

- 1) Strictly select customers to whom interest rate swaps may be marketed
- 2) Establish a framework for securing contracts based on customer's voluntary intention
- 3) Greatly revise proposal format

#### **(3) Establish Customer-Centric Business Framework**

- 1) Greatly revise the basic purposes of Corporate Business Offices from the customers' viewpoint
- 2) Fundamentally revise the rules on evaluating and awarding Corporate Business Offices for their performances
- 3) Establish rules on product planning with due consideration given to customer protection
- 4) Establish a Quality Management Dept. to which customers' opinions will be concentrated and analyzed by the department in order to reflect their opinions in management

### **4. Response to Customers' Inquiries, etc.**

Customers who have entered into interest rate swap contracts and have made inquiries or

demands with respect to their contracts will be given explanation individually of the results of the investigation by the special internal investigation committee and taken care of.

SMBC will respond earnestly and sincerely to customer inquires or demands, and the head office, not just the Corporate Business Offices, will be actively involved in properly answering inquires or demands, even from legal perspective.

## **5. Clarification of Responsibility**

Various problems with the head office, not just with the Corporate Business Offices, were confirmed with respect to this situation, and the management recognizes the need for an earnest self-examination. Therefore, the executives and employees responsible for causing the problems that led to the business suspension order and the business improvement order will be clearly specified and strict internal actions will be taken against them. The results of such actions will be published separately after the establishment of the business improvement plan pursuant to the business improvement order.

April 27, 2006

Sumitomo Mitsui Banking Corporation  
Special Investigation Committee

**Self Investigation Report on Abuse of Dominant Bargaining Position  
in Connection with Sale of Interest Rate Swap**

1. About the Report

On December 2, 2005, Sumitomo Mitsui Banking Corporation (SMBC) was issued a recommendation by the Fair Trade Commission of Japan (“JFTC”) based on several violations of Section 19 of the Antimonopoly Act (“Act”), particularly “Abuse of Dominant Bargaining Position” of Unfair Trade Practices, with respect to the manner in which it marketed interest rate swaps to its corporate clients. This issuance of the recommendation is pursuant to Section 48 (1) of the Act.

Based on this recommendation, we established the Special Investigation Committee (“Committee”) on December 14, 2005 in order to inspect whether there were any other cases similar to those JFTC pointed out and the factors of the incidents. This report summarizes the investigation led by the Committee.

2. About the Committee and Summary of the Investigation

(1) About the Committee

The Committee consists of five committee members headed by the Senior Executive Officer in charge of compliance in SMBC, three officers of SMBC and one outsider (lawyer). Under the Committee, we set up a subcommittee, which consists of six lawyers, including the above-mentioned outsider, and some SMBC’s officers who belong to Antimonopoly Monitoring Office, a segregated office from business promotion division of SMBC. There are no advisory contracts between these six lawyers and SMBC.

(2) Scope of Investigation

The Committee investigated the following:

- a) Individual cases: judgment on abuse of dominant bargaining position as to every interest rate swap agreement which SMBC signed after April 2001.
- b) Organizational factors that caused this incident.

(3) Way of Investigation on Individual Cases

- a) The total number of the clients who had interest rate swap agreements with SMBC during the abovementioned period turned out to be 18,162 including who had already terminated the agreements. First, we sent mails to all the clients out of 18,162 except who had already contacted us before this investigation. These mails were enclosed with questionnaire asking how they felt or recognized the abuse of dominant bargaining position by SMBC's staff upon marketing of interest rate swaps to them, and also asking for response in case they regarded the way of our promotion as questionable.
- b) Second, we have investigated 2,200 cases out of 18,162, where the clients made response or separately requested us to do so by other measures including phone calls. Specifically, i) the investigation staff of the subcommittee interviewed the related marketing staff and inspected the related documents according with the guidelines set through consultation with the lawyers. ii) The lawyers in the subcommittee conducted preliminary judgment on whether there existed any abuse of dominant bargaining position based on the reports by the investigation staff. iii) The Committee conducted the final judgment based on the result of the preliminary judgment by the subcommittee.

(4) Investigation on Organizational Factors

Regarding organizational factors which brought about the incidents, the Committee conducted investigation by asking the related departments in the head office to submit reports and related documents and interviewing the related directors and executive officers including heads of the related business promotion divisions.

3. Outcomes of the Investigation - Individual Cases -

- (1) The total number of investigation of the abuse of dominant bargaining position by the Committee is as follows:

Total number of applicable clients:	<u>18,162</u>
<b>Investigated:</b>	<b><u>2,200</u></b>
Based on response to the investigation:	1,523
Based on requests by other measures including telephone calls:	677

(2) The Outcomes of Final Judgments by the Committee: (\*)

<b>Cases of Abuse of Dominant Bargaining Position:</b>	<b>17</b>
<b><u>Cases of Possible Abuse of Dominant Bargaining Position:</u></b>	<b><u>51</u></b>
<b>Total</b>	<b>68</b>

(\*) Definition:

- Cases of Abuse of Dominant Bargaining Position:  
Where it is highly likely to be designated as abuse of dominant bargaining position in the case of litigation.
- Cases of Possible Abuse of Dominant Bargaining Position:  
Where there is a concern of abuse of dominant bargaining position and also a concern of designation as the abuse of dominant bargaining position by the judge in the case of litigation.

Besides, as a result of classifying cases with a conservative stance, there were 181 clients categorized into “The Cases of Possible Legal Liabilities” (the cases requiring further investigation due to possible violation of any laws or regulations such as breach of duties to make sufficient explanation to the client) that are not “The Cases of Abuse of Dominant Bargaining Position” or “The Cases of Possible Abuse of Dominant Bargaining Position.”

- (3) Interest rate swaps are marketed by several divisions and units of SMBC; however, the Committee found the above determined and questionable cases only in the Middle Market Banking Unit, which is doing business with mainly small and medium sized enterprises.

4. Outcomes of Investigation - Organizational Factor -

- (1) Through the investigation, the Committee found the several organizational behaviors to be improved in connection with interest rate swaps marketing as follows:

- a) In Middle Market Banking Unit, the profit targets have been set through discussion between Corporate Business Offices and Planning Department in head office. However, head office failed to analyze the performances and the process of obtaining such earnings in detail, and has been inclined to set the profit targets automatically based on the previous results with the assumption of certain rate of growth.

In addition, some Corporate Business Offices were assigned relatively high

target by the head office without sufficient analysis of the local circumstances.

As a result of such budget assignment process, mainly in the Middle Market Banking Unit that provides banking services with small and medium sized enterprises, some Corporate Business Offices urged interest rate swaps marketing because the demand of borrowings had been decreasing while revenues from interest rate swap were recognized up-front according to the mark-to-market accounting principle. Furthermore, some offices conducted extravagant marketing and abused dominant bargaining position.

- b) The head office's supervision of the Corporate Business Offices were centered on monitoring their progress in achieving their targets, and amid a situation of gross banking profit increasing in the term-end month, the head office failed to sufficiently analyze the profit and actual business promotion in details. In addition, the weight of earnings in single fiscal year in evaluation system was relatively heavier than that of mid-long term targets including growth of customer base, and the Committee considered this as one of the organizational factors behind the incidents.
- c) Although SMBC had established interest rate swap marketing rules from the compliance point of view, the rules had mainly focused on the structural explanation of the swaps as derivative products without enough consideration of characteristics of the clients including the size and profitability. Thus, the rules could not work effectively to prevent from the abuse of dominant bargaining position.
- d) The prevention from the abuse of dominant bargaining position had been stipulated indeed. However, the rule had failed to define the repeated canvass accompanied by senior officers as "implying", and had not worked effectively to prevent from such implying practices. This failure was also pointed out in the recommendation by JFTC. SMBC had also established the compliance system based on the self-discipline principle where each unit/office, with the support of head office, is individually responsible for the compliance. In this system, the compliance officer in each office is not completely independent from the business promotion line and the consideration for compliance was insufficient in the business budget/plan and the business promotion. The Committee attributes the incident also to these factors.
- e) The Committee also found that the framework to respond to customer complaints had not worked effectively because it focused on dealing with individual cases

- and not on improving the product itself and the monitoring system of interest rate swap marketing. In addition, there was a problem that the analysis of Customer Satisfaction Survey was insufficient in the Middle Market Banking Unit.
- f) In the internal audit of Corporate Business Offices regarding interest rate swap marketing, the Internal Audit Department had not conducted sufficient audit on the actual marketing by the office from antimonopoly point of view. Also, the audit of the head office had not worked effectively as it did not include prevention of abuse of dominant bargaining position.
  - g) Each related department in SMBC had respectively responded to the revision of the Guideline for Supervision by FSA and “the Report of Survey of Trade Practices between Banks and Firms, from the Viewpoint of Prevention of the Unfair Trade Practices on July 2001” by JFTC; but SMBC had not coped with them more in details to improve the business promotion system as a whole.
- (2) In summarizing the investigation by the Committee, there were problems in the Head Office and Corporate Business Offices respectively in connection with interest rate swap marketing and the compounded factors of these problems brought about the incident. In other words, we had set challenging budgets and promoted them, while we had failed to establish an effective internal control, checking and balancing system.
- (3) SMBC professes “Customer-Centric” in our Corporate Mission and mentions it in the Compliance Manual. However, considering the background of the incident, it is envisaged that the staff in the head office and Corporate Business Offices who engaged in promotion of interest rate swap had not thoroughly understood and kept in mind the “Customer-Centric” Concept.

End.

(Supplement)

**The Method of Making a Judgment on  
“Abuse of Dominant Bargaining Position”  
(Overview)**

**1. Requirements for “Abuse of Dominant Bargaining Position”**

(1) Following requirements must be met in order to assume that “Abuse of Dominant Bargaining Position” under the Japanese Antimonopoly Act (“ACT”). (Sec. 2-9-5, General Designation No. 14) exists in certain transactions:

*i Requirement of Position*

One of the parties to the transaction has Dominant Bargaining Position to the other.

*ii Requirement of Abuse*

One of the parties to the transaction presumably took advantage of the Dominant Bargaining Position over the other to cause unfair disadvantages to the other party. (specifically, taking actions described in General Designation No 14 item 1 to 5 of the Act.)

*iii Requirement of Impediment to Fair Competition*

One of the parties to the transaction presumably abused the Dominant Bargaining Position in such a manner that appears unfair from the view point of common market practice.

If certain transaction fails to meet any of the above requirements, no “Abuse of Dominant Bargaining Position” is presumed to exist in the transaction.

(2) *Requirement of Position* is met, in short, when one party is dependent on the other in conducting businesses; In the case of SMBC, the criteria to determine if certain transaction meets *Requirement of Position* is whether it is deemed difficult for the client of SMBC to procure necessary fund from financial institutions other than SMBC. The availability of necessary funds from other financial institutions as described above should be judged in light of the client’s business relations with SMBC and other financial institutions, its business performance, financial conditions, and so forth.

(3) *Requirements of Abuse* is met, in short, when one party took advantage of the stronger position (=dominant bargaining position) to force unfair disadvantage on the other. In the case of SMBC, the criteria to determine if

*Requirement of Abuse* is satisfied is whether, in order to force the client to purchase interest rate swap, the officer of SMBC took advantage of the client's situation that he has no choice but to borrow from SMBC, "explicitly stating" or "implying" that the "loan is conditioned on the purchase of interest rate swap" or the "refusal to purchase interest rate swap would result in unfavorable lending conditions".

In order to determine whether there was such an "explicit statement" or an "implication", such factors shall be taken into consideration as details of the process of entering into an interest rate swap agreement, frequency of meetings with the client, attendance of senior officer of SMBC at the meetings, and effectiveness of the interest rate swap to the client.

(4) *Requirement of Impediment to Fair Competition* is met when free and fair competition is deemed undermined due to involuntary transactions. This requirement is usually satisfied if *Requirement of Position* and *Requirement of Abuse* are both satisfied.

## 2. Method of Judgment Employed

(1) In the process of investigation, the Committee made a judgment on *Requirement of Position* and *Requirement of Abuse* in every case.

The Committee gave a priority to *Requirement of Position* because *Requirement of Position* must be met in order to meet *Requirement of Abuse* of Dominant Bargaining Position and it is possible to make a judgment on *Requirement of Position* to considerable extent by examining objective information on business relations, business performances, financial conditions, etc.

It should be noted that the Committee took a conservative approach in making a judgment on *Requirement of Position* because whether the requirement is met or not can be a crucial factor in the final judgment, and, accordingly, all the cases that could possibly meet *Requirement of Position* were referred to the step (2).

(2) The Committee examined *Requirement of Abuse* when *Requirement of Position* was deemed or could possibly be satisfied.

(3) The Committee categorized such cases into "The Cases of Abuse of Dominant Bargaining Position" or "The Cases of Possible Abuse of Dominant Bargaining Position" that satisfied or could possibly satisfy *Requirement of Position* and *Requirement of Abuse*.

Also, the Committee categorized such cases into “The Cases of Possible Legal Liabilities” (The Cases Requiring Further Investigation) that presumably failed to meet *Requirement of Position* but, as a result of further investigation of the process of entering into interest rate swap agreement, turned out to be in violation of any laws or regulations such as breach of duty to make sufficient explanation to the client.

(4) In the foregoing process, two lawyers of the Committee examined and made a judgment on every single case. If the conclusions of the two lawyers differ from each other, they made a final judgment after thorough discussion. Also, in case the lawyers need additional information, they asked Antimonopoly Monitoring Office of SMBC to conduct an additional research and made a judgment based on the result of the research.

(Over)