

RISK MANAGEMENT

The liberalization and globalization of financial markets, as well as rapid advances in information technology, are enabling financial institutions to expand business opportunities. At the same time, risks arising from these new business opportunities are growing rapidly and becoming more diverse and complex.

Sumitomo Bank recognizes risk management as the cornerstone of the Bank's operations and strikes a balance between "sound practices" and "profitability." Such equilibrium is achieved by first applying strict controls and limits, then maximizing returns.

Since the modification of the Bank's governance structure in June 1999, the roles of the Board of Directors in the risk management have been clearly defined, and the major principles of the risk management were set up. The Bank established the Risk Management Committee within the Board of Directors. Risk management at Sumitomo Bank is governed by the following set of principles:

- 1- Risk is to be managed on a consolidated basis.
- 2- The relevant department and the individual business units are to be mutually checked
- 3- Risk is to be assessed on the basis of quantitative standards.
- 4- Risk is to be managed by departments staffed with appropriately trained personnel and appropriately selected information systems.
- 5- The implementation of the Bank's risk management policies and procedures by the relevant departments as well as day-to-day business operations are to be subject to ex post supervision and investigation of the independent internal audit departments.

Risk management at Sumitomo Bank is deemed to include credit risk, market risk, liquidity risk and operational risk. With every type of risk, both the relevant departments and internal audit departments are specified.

At Sumitomo Bank, the process of decision-making in risk management is as follows. The relevant departments are responsible for raising matters for discussion by the Management Committee. The Management Committee takes a decision on such items. This decision is then subject to review by the Risk Management Committee of the Board of Directors. Any final decision must then win the approval of the Board of Directors itself.

The Bank intends to continue strengthening its overall business management system as well as improving the efficacy of its risk management.

Principal Types of Risk

Credit Risk: risk that a deterioration in the financial condition of a borrower will cause the asset value to decrease or be nullified. Country risk and settlement risk are included in this category.

Country Risk: risk of losses arising from foreign exchange rate, and economic or political changes that affect the country in which the loan is booked.

Settlement Risk: risk of losses through the failure of the counterparty to be able to pay on the settlement date due to bankruptcy or other causes.

Market Risk: risk of losses arising from unfavorable changes in the level or volatility of interest rates, foreign exchange rates or stock prices.

Liquidity Risk: includes market (product) liquidity risk and funding liquidity risk.

(a) Market (Product) Liquidity Risk: risk of losses incurred due to difficulty in accessing markets or products at the required time, price or volume.

(b) Funding Liquidity Risk: risk of the failure of the bank to settle at the settlement date or of the necessity of the bank to raise the funds at a higher rate than usual because of cash flow mismatches or unexpected fund outflows.

Operational Risk: risk relating to operating risk, system risk, compliance risk and other forms of associated risk.

Operating Risk: risk of losses arising due to staff mistakes, negligence or fraud.

System Risk: risk of losses due to failure, damage or improper use of systems.

Compliance Risk: risk of losses arising from inadvertent or purposeful/intentional non-compliance with laws, regulations and guidelines.

Other Risks: risk of losses arising from damage to the Bank's reputation in the market or among customers, natural disasters, crime, civil disorder or resignation of skilled staff.

CREDIT RISK MANAGEMENT

1. Credit Risk

Credit risk refers to the risk of default on loans (one of the Bank's principal assets) and off-balance sheet transactions due to deterioration in customer credit position(s). In October 1999, Sumitomo Bank introduced new basic guidelines for credit risk management that clarified the following issues:

- 1- Organization of credit risk management.
- 2- Basic principles of portfolio management to avoid excessive portfolio concentration and to enhance the risk/return profile.
- 3- Key factors for credit risk management such as quantitative measurement of risk, grading system(s), standards for portfolio management and a risk-return index.
- 4- Rules for reporting to the management concerning the current status of credit risk.

2. Organization for Credit Risk Management

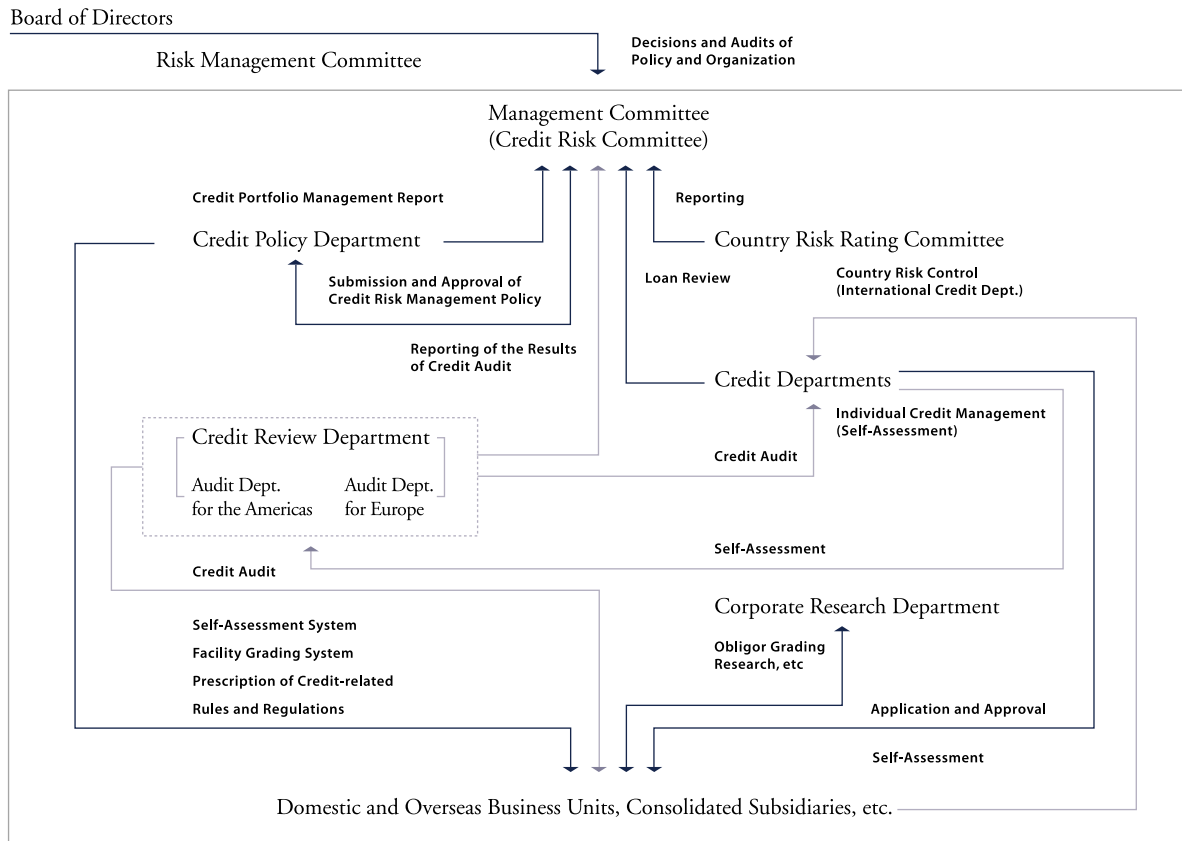
Sumitomo Bank's Credit Policy Department (CPD) has the responsibility for credit risk management. CPD monitors portfolio exposure by industry, obligor/facility grading, corporate size, product type and other characteristics in order to avoid excessive credit risk concentration. CPD also sets the basic rules for credit management, including the regulation of credit policy, credit-approval authority and other credit-related rules and regulations.

In addition to developing and establishing the obligor grading system, the Bank's Corporate Research Department (CRD) assigns a consistent and objective risk grade to every customer to which it has large-scale exposure. For each credit transaction, the business unit(s) responsible as well as the credit department in charge conduct a strict examination of the customer's creditworthiness and determine a facility grade. The relevant department(s) is then responsible for maintaining or altering this grade by adjusting the obligor grade upwards or downwards to reflect the risk associated with the characteristics of the facility. These characteristics include its purpose, tenor, guarantees, the level of collateral, and availability of other repayment sources. Credit department responsibilities for credit risk are segmented into the following categories: major corporations, small and medium-sized corporations, consumers in the domestic Japanese market, or the Americas, Europe and Asia for overseas business.

To manage country risk, the International Credit Department (ICD) analyzes the latest political, economic and financial conditions of a country on a regular basis with information collected through the Bank's global network. Thereafter, a rating is assigned to each country by the Country Risk Rating Committee and global portfolio management is subject to lending limits for each country based on its particular rating.

In April 2000, the Bank reorganized its credit audit system, greatly expanding the authority of the Credit Review Department (CRRD). The CRRD conducts regular audits of self-assessment(s) as well as of the setting of facility grades and the resultant process for facility grades in order to validate the soundness of credit management by each of the Bank's business groups.

Credit Risk Management Organization



3. Internal Grading System (Obligor Grade/ Facility Grade)

When extending credit, the Bank examines: (1) the customer's business, and (2) the financial and operational purpose of the facility as well as the level and availability of collateral. Sumitomo Bank believes that it is its mission as a financial intermediary to extend appropriate advice to customers. This advice is designed to aid the customer's well-being and development through the objective analysis of the above-mentioned factors.

The Bank's Internal Grading System reflects this situation by assigning an objective risk grade to each customer in accordance with each credit risk considered. Used in the management of credit portfolios and in the quantitative measurement of credit risk, this system provides an objective index that enables the Bank to manage credit risk effectively.

The Bank renovated the previous obligor grading system in 1996 and introduced the facility grading system in January 1999. Moreover, in April 2000, the Bank modified this system to include a more refined cash-flow analysis, thereby substantially enhancing the precision of individual decisions taken under the system.

4. Loan Review

Credits that might have a negative impact on the Bank's portfolio and profitability are strictly monitored. The Loan Review System ensures that the Bank's management is fully aware of the current status of such credits. CRRD designates the obligors to be reviewed, and the results of such reviews are periodically reported to the Management Committee by the relevant credit department(s).

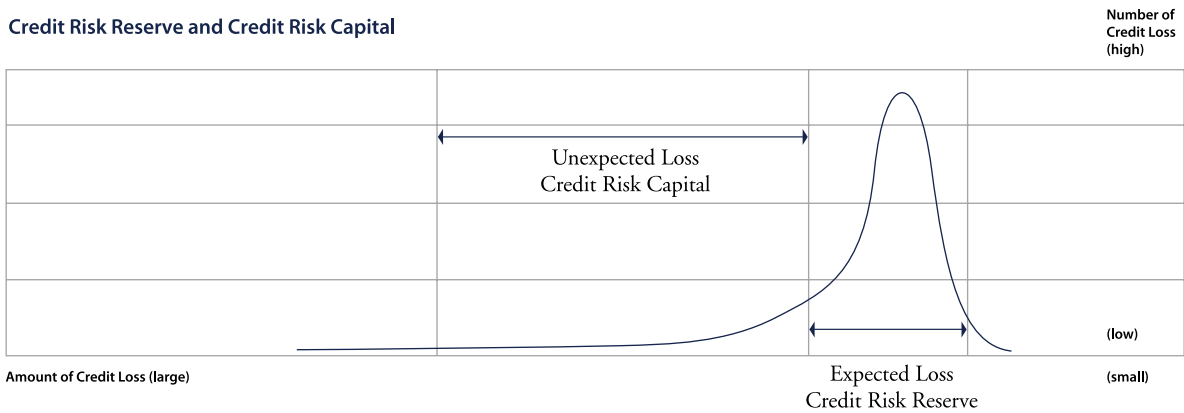
5. Quantitative Measurement of Credit Risk

Since fiscal 1998, the Bank has conducted quantitative measurements of credit risk in its lending portfolio. The point of such measurements is to grasp the changes in the quantitative value of the Bank's assets as the credit risk of borrowers fluctuates. The figure below demonstrates an asset value simulation. This computer model uses 10,000 simulations of the evolution of the Bank's asset value incorporating scenarios for loans, guarantees, bonds and other forms of exposure.

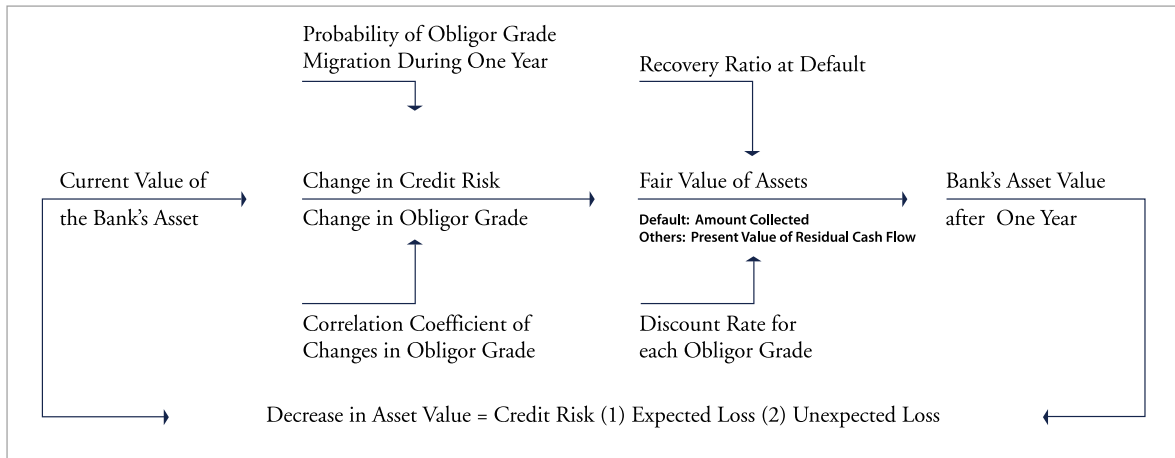
The graph below shows the distribution of asset values based on these 10,000 simulations. Two types of risk indicators can be obtained from the results of such simulations. One is "Expected Loss." This shows the amount of risk generated on average. Earnings (also known as the "Credit Risk Premium") should be such as to permit the absorption of such risk.

However, there is also a possibility that actual losses could be higher than in the past. For example, excessive losses were incurred in the case of loans made during the so-called "Bubble Economy." This highlights the importance of "Unexpected Loss," the second indicator. The Bank must hold sufficient capital to cover such unexpected losses and the amount of capital required for this is called "Credit Risk Capital." This is a very powerful tool for managing portfolio quality and enhancing the Bank's overall financial performance.

Credit Risk Reserve and Credit Risk Capital



Asset Value Simulation



6. Proper Risk/Return Profile

Financial institutions have to maintain adequate loan loss reserves for assets that contain inherent credit risks. Risk Adjusted Return on Assets (RAROA) is used in the Bank's credit risk management process to evaluate each customer's risk/return profile. RAROA considers not only the operational expenses related to the transaction, but also the probable losses that can be expected for each credit risk category. The expected loss for each transaction is a function of two major factors: the estimated default rate and the recovery rate which are derived from an analysis of data obtained from the Bank's historical records and external credit agencies.

7. Credit Application Control System

The Bank's "New Credit Pipeline System" (an integrated information system for credit control) has been introduced to shorten the decision-making process and streamline operations related to credit applications. It also enables the calculation of a facility grade, as well as storage of an obligor's general/collateral information electronically.

8. Off-Balance Sheet Transactions

For off-balance sheet transactions, the Bank calculates a credit risk equivalent amount. This represents the current replacement cost, or the cost to the Bank of restructuring future cash flows in the event of default. While the Bank calculates the potential risk, or the future change of the replacement cost of off-balance sheet transactions according to market fluctuations, it also makes every effort to implement advanced credit risk management of off-balance sheet transactions.

The Bank's basic approach to managing this type of exposure is to set counterparty credit lines denominated by the credit risk equivalent amount. By doing so, the Bank can measure and monitor credit risk for both on-balance- and off-balance-sheet assets on a unified basis. Sumitomo Bank periodically values the outstanding credit risk exposure to each counterparty - on a daily basis for general business corporations, and on a real-time basis for financial institutions. Should the Bank's exposure to any one counterparty exceed a certain percentage of the approved limit, the account is automatically flagged and control measures are implemented before the limit is breached.

MARKET RISK AND LIQUIDITY RISK

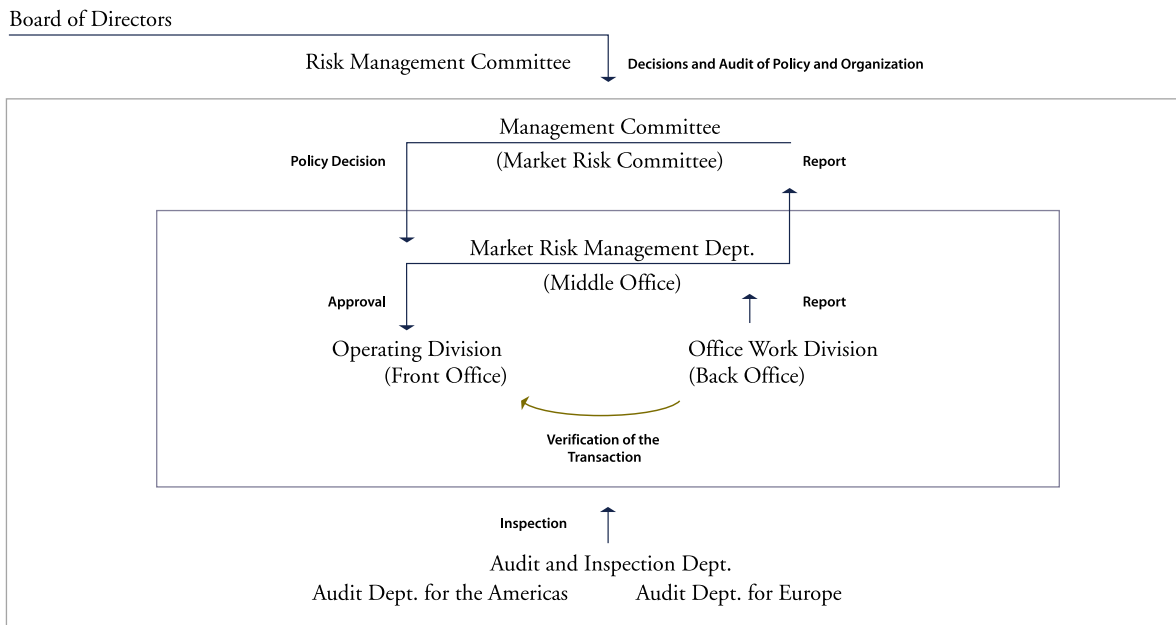
1. Organization of Market Risk and Liquidity Risk Management

The Market Risk Management Department (MRMD) manages market risk at the Bank and operates independently of the treasury departments. To ensure effective management of market risk, Bank executives at the highest level are involved in the decision-making process. Risk management policy is determined at the Market Risk Management Meeting (formed from within the Management Committee), deliberated by the Risk Management Committee (formed from within the Board of Directors) and approved by the Board of Directors. In addition, executives receive daily reports from MRMD.

To prevent operating errors and the potential manipulation of transaction data, it is vital for a system of checks and balances to be in place in the front office. The Bank's system is organized so that checks are conducted by both the back and middle offices. Furthermore, the independent Audit and Inspection Department conducts comprehensive audits regularly.

To provide advanced services and to exercise adequate control over risk, staff are trained in the latest financial techniques and technologies. The Bank invests in training and development programs to ensure that its staff have a professional understanding of derivatives, diversified portfolio management and other sophisticated financial management tools.

Market Risk - Liquidity Risk Management Organization



2. Market Risk Management Methods

Market risk arises from unanticipated changes in market prices or volatility. To consolidate and manage risk, the Bank uses the Value at Risk (VaR) method, which calculates the largest estimated loss that could occur with a specific probability. These values are calculated based on a one-day holding period and a 99.0% confidence interval.

Market risk can be broken down into various types of risk, including exchange rate risk, interest rate risk, stock price risk and option risk. To complement the VaR method, the Bank manages each of these risk categories with Basis Point Value (BPV, or the change in profit/loss given an interest rate change of 0.01%) and other indicators used in daily operations to provide still more detailed analysis to enhance risk management.

Market fluctuations may occasionally exceed predicted levels. To ensure its ability to manage and respond to these fluctuations, the Bank regularly conducts simulations of radical market movements (stress tests). Such stress tests ensure that the Bank is prepared to respond should similar situations occur in future.

Sumitomo Bank policy sets the total VaR at a conservative level based on its capital ratios (the amount of risk capital allocated to each department). When the possibility of total VaR exceeding established guidelines arises because of sudden market movements, the Bank convenes its ALM (Asset Liability Management) Committee to revise risk targets. In addition, market risk borne by departments other than the treasury departments, such as that associated with cross-shareholdings, and market risk borne by principal subsidiaries are controlled by calculating VaR regularly and reporting the results to the Management Committee and the Board of Directors.

Banking Account

a. Market Risk from April 1, 1999 to March 31, 2000

The following chart states the banking account's exposure to market risk over fiscal 1999 assuming a one-day holding period and a confidence interval of 99.0%.

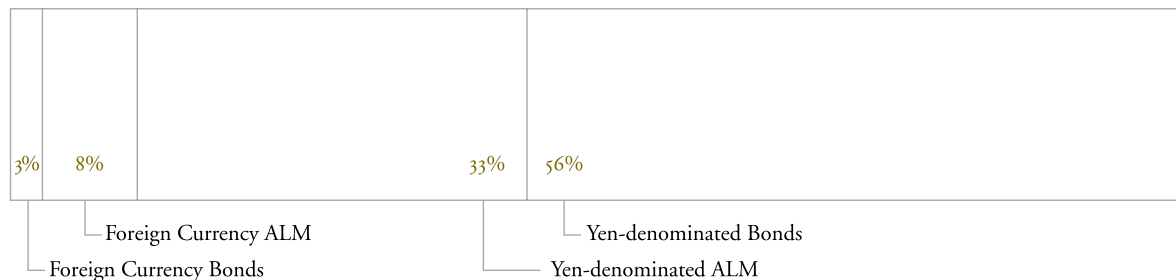
<i>(Billions of yen)</i>	Maximum	Minimum	Daily Average	Last Day of Term
Banking Account	28.49	15.73	20.93	17.40

b. Market Risk by Financial Product

The following chart illustrates the composition of VaR as of March 31, 2000.

Proportion of VaR by Product

As of March 31, 2000



c. Calculation of Earnings at Risk (EaR)

In addition to managing consolidated market risk with the VaR method, Sumitomo Bank also analyzes and calculates the EaR of its yen-denominated banking accounts. The measurement of the potential earnings impact of a specific movement in interest rates over a given period and for a given probability interval allows the Bank to formulate policies and budgets based on earnings for the period in question. This also means that the EaR method may be used to supplement VaR analysis. In this way, the Bank gains a better understanding of the potential impact that new deposits and loans may have on its earnings. Approximately 1,000 interest rate scenarios are generated by Monte Carlo simulation to measure the EaR for a given period.

In fiscal 2000, the EaR of yen-denominated banking accounts has been estimated, with a confidence interval of 99.0%, to be at the 11% level with regard to estimated earnings for the period based on market interest rates, as of March 31, 2000.

Trading Account

a. Market Risk between April 1, 1999 and March 31, 2000

The following chart states the exposure to market risk of the trading accounts of Sumitomo Bank and Sumitomo Bank Capital Markets, Inc. (SBCM) over fiscal 1999. It assumes a one-day holding period and a confidence interval of 99.0%.

<i>(Billions of yen)</i>	Maximum	Minimum	Daily Average	Last Day of Term
Trading Account	2.71	0.48	1.18	0.76

b. VaR Calculation Model

To calculate VaR, the Bank estimates the maximum loss amount by performing a Monte Carlo simulation of profit/loss changes in which 10,000 market fluctuation scenarios are run based on data for the preceding 12-month period. This method is suitable for measuring the risk of derivative products including options, and is effective for calculating VaR relating to active trading operations.

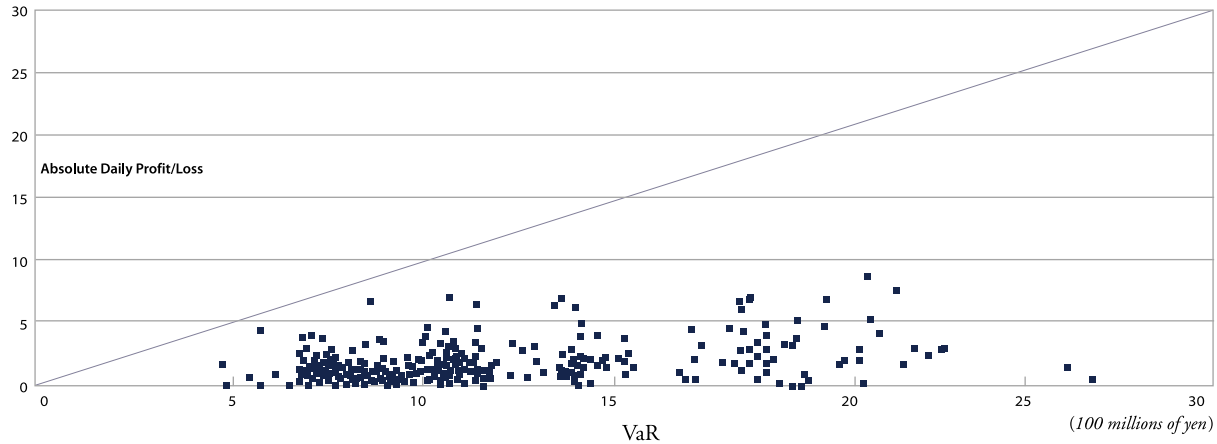
c. Back Testing

The Bank and SBCM use an internal model to measure VaR and to carry out back testing in order to verify the reliability of the model. The attached chart shows the back testing results for fiscal 1999. The data points above the line indicate the days on which profit/loss (absolute value) exceeded the Bank's predicted VaR. The profit/loss (absolute value) were all within the range predicted by the VaR method, demonstrating the reliability of the Bank's VaR model, based on a confidence interval of 99.0%.

Back Testing Results

(100 millions of yen)

April 1999 - March 2000



d. Stress Tests

The Bank uses the two types of stress tests noted below. The results of these tests are regularly reported to management, and, when necessary, appropriate countermeasures, such as reducing the Bank's positions, are taken.

(i) **Tests based on historical scenarios:** In this method, a calculation is made of the maximum daily loss generated when patterns of exchange-rate, interest-rate or bond-market values fluctuate at times of stress, such as Black Monday. The resulting values are applied to the current position, and the effect on the Bank's portfolios is measured.

(ii) **Tests based on forecast scenarios:** In this method, the range of fluctuation of certain specified risk factors (e.g. the yen/dollar exchange rate or interest rates on 10-year government bonds) is determined, and then the most likely fluctuations in other risk factors based on historical data are estimated. The maximum loss generated on a daily basis when these fluctuation patterns are applied to the current position is calculated to ascertain weaknesses in the portfolio.

3. Liquidity Risk Management Methods

Market (Product) Liquidity Risk

Market (product) liquidity risk refers to threats to the Bank's access to markets and to financial products. Either makes it difficult for Sumitomo to engage in the desired volume of transactions at appropriate prices. The Bank considers market (product) liquidity risk when establishing limits for the risk-control indicators that it uses for market transactions. When the Bank determines there is danger of market (product) liquidity risk occurring, it convenes a provisional meeting of the ALM Committee. After examining its operating policies and reviewing the risk control framework, the Committee reports promptly to the Board of Directors.

Funding Liquidity Risk

Funding liquidity risk refers to the danger that the Bank might be unable to settle its obligations on settlement dates or be forced to borrow at an unusually high premium, due to cashflow mismatches or because of unexpected fund outflows that make it difficult to raise funds.

Foreign-currency and yen-denominated exposure to liquidity risk is managed by the Management Committee, which determines the Bank's funding policy based on market circumstances and trends in deposits and loans, among other factors. The Committee manages this risk by setting limits and guidelines with respect to its funding requirements, i.e., the money gap.

The Bank has also prepared comprehensive contingency action plans to reduce money-gap limits and guidelines in response to market crises. Moreover, for holdings in highly liquid assets, such as U.S. treasury bonds, the Bank has facilities in place for sourcing daily funding needs even in times of market confusion.

4. System Risk Control

“System risk” in the banking industry refers to the risk that the Bank may be unable to provide services to its customers or may incur losses because of problems such as a computer system failure or malfunction. With recent developments in the computerization of the banking industry, risks arising from computer system failure or similar problems have grown significantly.

In order to maintain the safety, integrity and reliability of its computer systems, the Bank observes, as a matter of policy, a high level of system risk control preparedness in the operation of its computer systems. Such preparedness includes rigorous security policies and concrete control standards. Specifically, the Bank has ensured its computer systems operate safely by building redundancy into the infrastructure of each of its systems and creating a system of mutual back-up between the data centers located in eastern and western Japan. Disaster training drills are regularly carried out. Furthermore, as Internet transactions become more popular, the Bank is making every effort to protect customer privacy and to prevent the disclosure of information by encrypting sensitive and other important information, while taking countermeasures to prevent unauthorized external access.