President's Message

Yoshifumi Nishikawa
President and Chief Executive Officer

Sumitomo Mitsui Banking Corporation will soon mark the first anniversary of its inception. During this crucial period, I have remained intently focused on meeting the high expectations of our customers and shareholders while fulfilling our responsibility to contribute further to the Japanese economy. This is why I have been placing priority on two objectives: quickly establishing sound and strategically positioned post-merger operating foundations and leveraging the benefits of the merger to yield the maximum real returns for SMBC and its customers. This stance has enabled us to generate merger-related benefits that already greatly surpass our targets for this year.

The operating environment for financial institutions in Japan is rapidly deteriorating as economies weaken worldwide while deflationary trends, signified by slumping asset values and stock prices, take hold throughout the country. In response, we are making a concerted effort to build strong operating and financial foundations capable of withstanding even the most difficult business conditions. I believe that SMBC must start over from the very beginning, driven by a sense of urgency. We must act quickly and decisively to become an even more trusted source of financial services and information for our valued customers while emphasizing above all growth in shareholder value.

To meet these challenges head on, we are undertaking a four-point action plan: improving asset quality faster, implementing additional restructuring initiatives, bolstering our ability to absorb risks associated with stock market volatility, and reengineering business practices to build a more robust profit structure.

Improving Asset Quality

First of all, we are accelerating the improvement of asset quality by rapidly completing the work-out of non-performing loans and maintaining sufficient reserves to deal with future deterioration in our loan portfolio. We are focusing on loans to borrowers requiring caution. In line with this policy, we have increased reserves in a manner that adequately reflects recent trends in the generation of defaults and bankruptcies. However, our actions are not limited to write-offs and reserves. Our most important initiative of all is to take an active role in revitalizing borrowers. In every case, we formulate plans tailored to the needs of the borrower as part of our effort to deal with problem loans in a proactive and uncompromising manner.

Additional Restructuring Initiatives

We have been conducting an exhaustive cost-cutting program since the first day of operations at SMBC. Every area comes under strict scrutiny. We have already achieved one of the highest efficiency ratios (i.e., lowest expense ratios) among major Japanese banking groups. Aiming higher, we are now broadening and speeding up this program. For example, we are closing overlapping branches and reexamining our branch network strategy. Our post-merger benefits in system investment and administrative efficiency are allowing us to cut computer system and facility-related expenses by 20% each.

We plan further reductions in the number of employees by streamlining administrative sections and integrating branches. Cost cutting extends to directors as well, where we are revising remuneration. Similar actions will lower payments to SMBC Group companies for the outsourcing of services. We estimate that such cost-containment efforts will bring expenses down to ¥630 billion in the fiscal year ending in March 2005. This is about a ¥100 billion improvement over the original target for the current fiscal year. But it is not our ultimate goal. We will relentlessly seek more savings, with the goal of speedily reducing annual expenses to ¥600 billion.

Bolstering Capability to Withstand Stock Market Volatility

To reduce the potential impact of stock price movements on stockholders' equity, we are selling stockholdings and creating a more resilient capital structure. At the end of September 2001, SMBC held approximately ¥4,900 billion of listed and OTC stocks, excluding investments in subsidiaries and affiliates. Selling a significant percentage of these holdings is obviously essential to lowering our exposure to market risk. We will, of course, meet the Japanese government limit on bank stockholdings that will take effect in fiscal 2004. Our plan, however, is to act still faster, selling our holdings so as to drop well below this limit.

Further, we plan to transfer to retained earnings the portion of our legal reserves that exceeds capital stock. This transfer conforms to a 2001 amendment to Japan's Commercial Code and will require the approval of shareholders and creditors. With mark-to-market accounting applied from fiscal 2001 to available-for-sale securities classified as "other securities," approximately 60% of the difference between evaluation gains and losses must be recorded under stockholders' equity as "net unrealized gains (losses) on other securities." When there are net unrealized losses, the maximum amount of distributable profit is calculated by deducting net unrealized losses from retained earnings. This is why we are changing our capital structure and boosting retained earnings to function as a kind of "shock absorber" so as to lessen the direct impact of stock price volatility.

By thus reducing stockholdings and modifying the capital structure so as to form a bigger financial cushion, SMBC will become much less susceptible to the effects of stock market movements.

Reengineering Business Practices

Our steps to reengineer business practices are aimed at building a more robust profit structure. Increasing the gross profit from core operations is essential to our ability to achieve sustained growth. By radically altering our envisioned approach to all major businesses, we will shape an organization that can maintain high profitability as well as excellent asset and capital efficiency. To take the lead in this drive, I am serving as chairman of the Business Reform Committee, which was formed in the second half of fiscal 2001. By focusing on company-wide themes, we will enact reforms that span the entire SMBC organization rather than remain confined to individual business units. Success will depend on our ability to extend financial services that represent solutions to the unique requirements of each and every customer. We will consistently apply this approach so that customers come to recognize the value of the services we provide. I am confident that this process will lead to steady gains in gross banking profit from the following fiscal year onward.

Lastly, I would like to point out that although this is a critical time for all Japanese financial institutions, it is also a time of opportunities for us at SMBC. We are drawing on all our expertise and experience to surmount the challenges ahead. Doing so will undoubtedly give rise to unprecedented ideas and bold initiatives. This is, therefore, the time for SMBC to tap its immense inner resources to overcome the challenges before us, and emerge stronger than ever before.

All of us within the SMBC Group are rededicating ourselves to our mission to provide optimum added value to our customers and to create sustainable shareholder value. As always, our actions must reflect the high expectations and great social responsibilities that accompany our prominent position in Japan's financial services industry. I am determined to fulfill these expectations and responsibilities by moving quickly and decisively toward our goals.

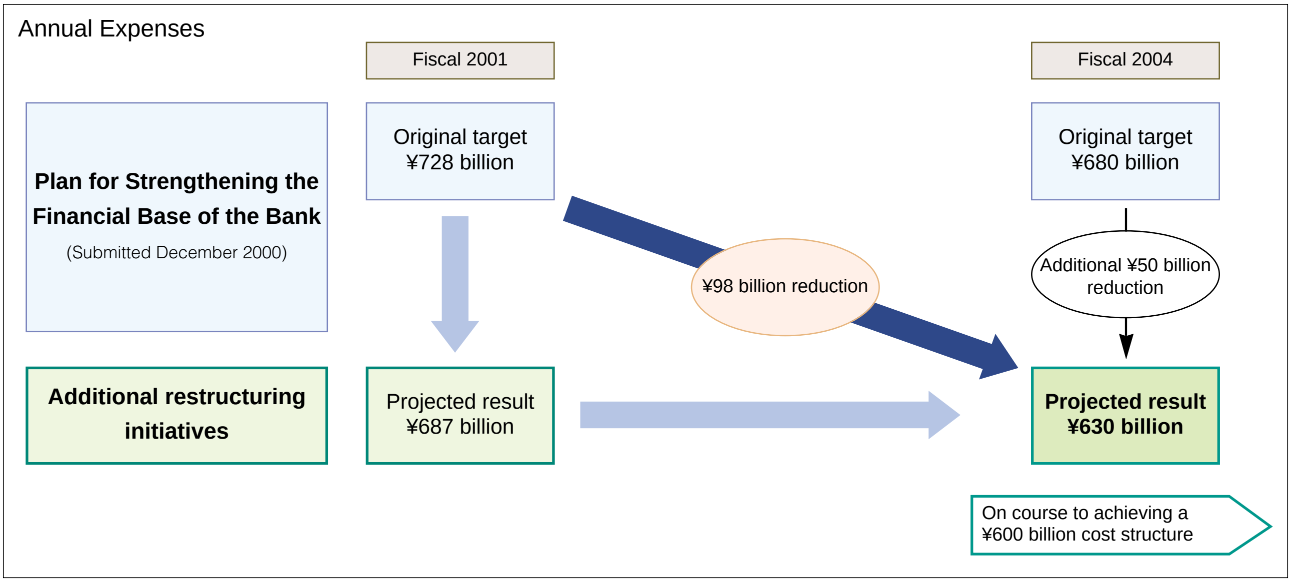
Yoshifumi Nishikawa
President and Chief Executive Officer

February 2002

Reference

Restructuring to Cut Expenses and Build Stronger Foundations

■ Expense Reduction Plan



■ Additional Restructuring Initiatives

(1) Further cuts in product channel expenses

- **To reduce the number of domestic branches from 578 (at the time of the merger) to 401** (reduction of 177, a reduction of 69 more branches than that of the Plan for Strengthening the Financial Base of the Bank) by eliminating overlapping branches and by reexamining the branch network strategy
- Within the reduction of 177 branches, **integration of 34 branches with other branches will take place in fiscal 2001, earlier than planned,** and the remaining 143 branches will be integrated in fiscal 2002

(2) Further cuts in facility-related expenses

To reduce facility-related expenses by reducing the number of branches, terminating the lease of the Kudan head office, integrating the system and back office centers, and selling company housing

→ Cut occupancy and other facility-related expenses by 20 percent

(3) Further cuts in system-related expenses

To exploit merger-related opportunities to streamline our systems infrastructure and use Business Process Reengineering to rationalize processing operations

→ Cut computer system and administrative expenses by 20 percent

(4) Further workforce slimming

To reduce the headcount from 27,500 (as of March 31, 2001) to 22,600 (reduction of 4,900, a reduction of 600 more than that of the Plan) by March 31, 2004 by streamlining administrative sections and reducing the number of branches

(SMBC plans to cut 1,100 employees in fiscal 2001)

(5) Further action on compensation

- To review remuneration for directors
(SMBC plans to make further cuts in the number of directors and their compensation)
- To reduce fiscal 2001 bonuses for employees

(6) Other actions

Boost productivity of SMBC Group companies to reduce expense of outsourcing services within the Group

Transfer of a Part of Legal Reserves to Retained Earnings

Q. What are Legal Reserves?

A. Legal Reserves are the amounts required to be set aside in reserve for possible losses, etc. in the future. Legal Reserves consist of the Capital Surplus, which is comprised of items such as part of the capital paid in by shareholders, and the Earned Surplus Reserve, which is part of the accumulated historical profit earned.

Japanese laws stipulate reservation of the Capital Surplus and the Earned Surplus Reserve. In addition to these Legal Reserves, companies are permitted to make voluntary reserves. Retained Earnings are comprised of these voluntary reserves and unappropriated income (loss) for the current year.

Capital Stock, Legal Reserves and Retained Earnings are included in the Stockholders' Equity section of the balance sheet which companies are required to prepare every fiscal year in order to show their financial conditions.

Theoretically, as the proportion of the amount of Stockholders' Equity to the amount of liabilities increases, the probability for creditors to collect their claims will become higher. In Japan, banks are required by regulation to have more Legal Reserves than other corporations because there must never be a case that a bank is unable to meet the withdrawal demands of its depositors.

Q. What is the transfer of Legal Reserves to Retained Earnings?

A. In general, having an abundant amount of Capital Stock, Legal Reserves and Retained Earnings may give a relief to creditors, but on the other hand, it is thought that an excessive amount of Legal Reserves, which can only be used for certain limited purpose, is not desirable from the viewpoint of efficient use of capital.

Meanwhile, the Japanese Commercial Code and Banking Law were amended in October 2001, and companies are allowed to transfer Legal Reserves to Retained Earnings, which may be used more freely than Legal Reserves.

The required amount of Legal Reserves after the amendment is as follows:

In the case of banks:

An amount equivalent to Capital Stock (example: in the case of Capital Stock of ¥1 trillion, the minimum amount of Legal Reserves is ¥1 trillion).

In the case of other corporations:

An amount equivalent to a quarter of Capital Stock (example: in the case of Capital Stock of ¥1 trillion, the minimum amount of Legal Reserves is ¥250 billion).

If the amount of accumulated Legal Reserves exceeds the required amount of Legal Reserves, the excess amount is allowed to be deducted from Legal Reserves and used effectively for the benefit of shareholders.

In the case of SMBC, Capital Stock is ¥1,326.7 billion and Legal Reserves are ¥1,925.7 billion. Therefore, we desire to transfer Legal Reserves of ¥599.0 billion to Retained Earnings. After this transfer, Legal Reserves will be ¥1,326.7 billion, an amount equivalent to Capital Stock and thus allowable under the amended law.

Q. The meaning and the background of the transfer

A. From the beginning of fiscal 2001, mark-to-market accounting on Available for Sale Securities (Other Securities) was introduced. Based on this accounting method, banks have started to recognize approximately 60% (due to recognition on an after tax basis) of the net of evaluation gains and losses on Other Securities (based on the market value calculated by using the average market price during the term-end month) including stockholdings as Net Unrealized Gains (Losses) on Other Securities in the Stockholders' Equity account.

By law, dividends must be paid only from Retained Earnings. In other words, payment of dividends in excess of the amount of Retained Earnings is prohibited. The mark-to-market accounting requires us to deduct Net Unrealized Losses on Other Securities (if any) from Retained Earnings that are distributable as dividends. This means that even though SMBC has enough Retained Earnings, it is possible that SMBC will not be allowed to pay dividends if stock prices during the last month of the term are too low (regardless of stock prices thereafter).

Considering the above-mentioned condition and the uncertain prospects of the stock market, a financial cushion such as more Retained Earnings to absorb the impact of the stock market volatility risk is indispensable to meet shareholders' expectations of SMBC.

The foregoing is the meaning and the background of the transfer of part of Legal Reserves to Retained Earnings.

Q. What is the effect on the creditors, including depositors?

A. The purpose of this transfer is to meet shareholders' expectations by effectively utilizing our capital. The transaction is the transfer of a part of Legal Reserves to Retained Earnings, which means that the transaction will take place within the Stockholders' Equity section of the balance sheet. The total amount of Stockholders' Equity will remain unchanged, so we believe that the transfer will have no adverse effect on our creditors, including depositors.

We assure you that SMBC is fully committed to pursuing a capital structure which is highly resistant to the impact of stock market volatility risk by various measures, including the transfer of a part of Legal Reserves to Retained Earnings.