

## Asset Quality

SMBC provides information about the status of its assets in three different ways. First, we conduct self-assessment to calculate appropriate write-offs and reserves by classifying borrowers according to their financial soundness. Second, disclosure based on “The Law Concerning Measures for the Reconstruction of the Functions of the Financial System” (the Financial Reconstruction Law) is used to classify problem assets. (Note: Disclosure on the basis of the Financial Reconstruction Law is related to self-assessment in terms of borrower category.) Third, we disclose the value of Risk-Monitored Loans based on the Banking Law, which excludes non-loan assets such as foreign exchange, accrued interest, and suspense payments.

### Disposal of Problem Assets for the First Half of Fiscal 2002

SMBC makes appropriate write-offs and reserves based on semi-annual self-assessments conducted in compliance with the *Financial Inspection Manual* prepared by the Financial Services Agency and the *Practical Guideline* published by the Japanese Institute of Certified Public Accountants.

At SMBC, the disposal of problem assets is our most urgent management issue in light of the challenging economic environment the Bank continues to face. In strict accordance with government policies for off-balancing, during the first half of fiscal 2002, the six months ended September 30, 2002, we accelerated the process of reorganizing and restructuring problematic corporate borrower companies with large exposures.

As a result, on a nonconsolidated basis, the Bank's total credit cost—a category including the transfer to general reserve for possible loan losses—amounted to ¥266.3 billion, bringing the total reserve for possible loan losses to ¥1,872.6 billion.\*

On a consolidated basis, total credit cost stood at ¥318.6 billion, with the total reserve for possible loan losses at ¥2,049.5 billion.\*\*

\* All Classification IV assets are basically directly written off using the direct reduction method even if the assets were not classified as tax-free write-offs. The amount of direct reduction totaled ¥1,398.8 billion.

\*\* The amount of direct reduction totaled ¥1,768.0 billion.

### Self-Assessment

Self-assessment is a preparatory task prior to calculating the appropriate level of write-offs and reserves to ensure the Bank's asset quality. Each asset is assessed individually for its security and verity. Depending on its current condition, each borrower is assigned to one of five categories: Normal Borrowers, Borrowers Requiring Caution, Potentially Bankrupt Borrowers, Effectively Bankrupt Borrowers, or Bankrupt Borrowers. The risk of default and noncollection and the risk of asset devaluation are then assessed on a scale from I to IV. As part of our efforts to bolster risk management throughout the Group, our consolidated subsidiaries, in principle, employ the same standards.

Borrower Categories, Defined	
Normal Borrowers	Borrowers with good business performance and in good financial standing without identified problems
Borrowers Requiring Caution	Borrowers identified for close monitoring
Potentially Bankrupt Borrowers	Borrowers perceived to have a high risk of falling into bankruptcy
Effectively Bankrupt Borrowers	Borrowers that may not have legally or formally declared bankruptcy but are essentially bankrupt
Bankrupt Borrowers	Borrowers that have been legally or formally declared bankrupt

Asset Classifications, Defined	
Classification I	Assets not classified under Classifications II, III, or IV
Classification II	Assets perceived to have an above-average risk of noncollectibility
Classification III	Assets for which final collection or asset value is very doubtful and which pose a high risk of incurring a loss
Classification IV	Assets assessed as uncollectible or worthless

### ■ Credit Cost (Nonconsolidated; six months ended September 30, 2002)

(Billions of yen)

Credit cost	¥ 245.7
Write-off of loans	88.9
Transfer to specific reserve	140.6
Transfer to reserve for losses on loans sold	7.1
Losses on loans sold to CCPC	3.0
Losses on sale of delinquent loans	10.0
Transfer to loan loss reserve for specific overseas countries	(3.9)
Transfer to general reserve for possible loan losses	20.6
Total credit cost	¥ 266.3
Reserve for possible loan losses	¥1,872.6
Amount of direct reduction	¥1,398.8

### ■ Credit Cost (Consolidated; six months ended September 30, 2002)

(Billions of yen)

Total credit cost	¥ 318.6
Reserve for possible loan losses	¥2,049.5
Amount of direct reduction	¥1,768.0

### ■ Reserve for Possible Loan Losses (September 30, 2002)

(Billions of yen)

	Nonconsolidated	Consolidated
Reserve for possible loan losses (a)	¥1,872.6	¥2,049.5
General reserve	892.9	946.7
Specific reserve	968.2	1,091.3
Loan loss reserve for specific overseas countries	11.5	11.5
Risk-monitored loans (b)	¥5,630.9	¥6,235.3
Reserve ratio (a) / (b)	33.3%	32.9%

### □ Write-Offs and Reserves Assessments

Under self-assessment, each borrower is evaluated and assigned to one of five categories—Normal Borrowers, Borrowers Requiring Caution, Potentially Bankrupt Borrowers, Effectively Bankrupt Borrowers, or Bankrupt Borrowers—and standards for write-offs and reserves are applied to each category.

Self-Assessment Borrower Categories	Standards for Write-Offs and Reserves
Normal Borrowers	Amounts are recorded as general reserves in proportion to the expected losses over the next 12 months based on the actual past bankruptcy rate for each category.
Borrowers Requiring Caution	These assets are divided into groups according to the risk of default. Amounts are recorded as general reserves in proportion to the expected losses based on the actual past bankruptcy rate for each group. The groups are "substandard borrowers" and "other." The latter group is further divided according to credit situation, etc.
Potentially Bankrupt Borrowers	The Bank sets specific reserves for possible loan losses on the portion of Classification III assets (calculated for each borrower) not secured by collateral, guarantee, or other means.
Effectively Bankrupt/Bankrupt Borrowers	Of each borrower's assets classified as Classification III or IV assets, in principle, the Bank writes off the full amount of Classification IV assets (deemed to be uncollectible or of no value) and sets aside specific reserves for possible loan losses against the full amount of Classification III assets.

As part of our overall measures to strengthen risk management throughout the Group, all consolidated subsidiaries, in principle, use the same standards as the parent Bank for write-offs and reserves.

## Disclosure of Problem Assets

### 1. Problem Assets Based on the Financial Reconstruction Law

Under the Financial Reconstruction Law, assets are assessed and classified into four categories: Bankrupt and Quasi-Bankrupt Assets, Doubtful Assets, Substandard Loans, and Normal Assets.

On a nonconsolidated basis, the total value of assets in all categories other than Normal Assets amounted to ¥5,703.1 billion as of September 30, 2002. A decline was noted in the Bank's Doubtful Assets compared with March 31, 2002, thanks to progress made on the off-balancing of problem assets as well as

reorganization and restructuring of borrower companies. However, Substandard Loans increased during the same period, a result due partly to strict application of the restructured loan category for each loan and a portion of borrowers remaining in the same borrower category after business reorganization and restructuring. As a result, the Bank recorded a first-half reduction in disclosed assets of ¥196.9 billion.

On a consolidated basis, the total value of assets in all categories other than Normal Assets amounted to ¥6,316.5 billion.

### ■ Problem Assets Based on the Financial Reconstruction Law (September 30, 2002)

(Billions of yen)

	Nonconsolidated	Compared with March 31, 2002	Consolidated
Bankrupt and quasi-bankrupt assets	¥ 514.8	¥ 21.3	¥ 653.3
Doubtful assets	2,541.4	(428.8)	2,785.0
Substandard loans	2,646.9	210.6	2,878.2
Subtotal	¥ 5,703.1	¥ (196.9)	¥ 6,316.5
Normal assets	59,534.5	(1,024.4)	60,899.2
Total	¥65,237.6	¥(1,221.3)	¥67,215.7
Amount of direct reduction	¥ 1,398.8		¥ 1,768.0

### ■ Classification under Self-Assessment, Disclosure of Problem Assets, and Write-Offs/Reserves (Nonconsolidated; September 30, 2002)

(Billions of yen)

Category of borrowers under self-assessment	Problem assets based on the Financial Reconstruction Law	Classification under self-assessment				Reserve for possible loan losses	Reserve ratio
		Classification I	Classification II	Classification III	Classification IV		
Bankrupt Borrowers	Bankrupt and quasi-bankrupt assets (1) ¥514.8	Portion of claims secured by collateral or guarantees, etc. (4) ¥494.9	Fully reserved ¥19.9	Direct write-offs (Note 1)	Specific reserve ¥24.0 (Note 2)	100% (Note 3)	
Effectively Bankrupt Borrowers							
Potentially Bankrupt Borrowers	Doubtful assets (2) ¥2,541.4	Portion of claims secured by collateral or guarantees, etc. (5) ¥1,241.2	Necessary amount reserved ¥1,300.2		¥944.2 (Note 2)	72.6% (Note 3)	
Borrowers Requiring Caution	Substandard loans (3) ¥2,646.9	Portion of substandard loans secured by collateral or guarantees, etc. (6) ¥1,213.6			General reserve for substandard loans ¥311.8	21.8% (Note 3)	
	(Claims to substandard borrowers)					5.3% [10.1%] (Note 4)	
Normal Borrowers	Normal assets ¥59,534.5	Claims to borrowers requiring caution, excluding claims to substandard borrowers			General reserve ¥892.9	13.9% (Note 3)	
		Claims to normal borrowers				0.2% (Note 4)	
Loan loss reserve for specific overseas countries					¥11.5		
Total ¥65,237.6		Total reserve for possible loan losses			¥1,872.6	Reserve ratio (Note 5) (B) / (D) 46.5%	
		(B) Specific reserve + General reserve for substandard loans			¥1,280.0		
(A)=(1)+(2)+(3) ¥5,703.1		Portion secured by collateral or guarantees, etc. (C)=(4)+(5)+(6) ¥2,949.7		Unsecured portion (D)=(A)-(C) ¥2,753.4	74.2%		
Coverage ratio {(B)+(C)} / (A)							

Notes: 1. Includes amount of direct reduction totaling ¥1,398.8 billion.

2. Includes reserves for assets that are not subject to disclosure under the Financial Reconstruction Law disclosure standards. (Bankrupt/Effectively Bankrupt Borrowers: ¥4.1 billion; Potentially Bankrupt Borrowers: ¥12.5 billion)

3. Reserve ratios for claims to Bankrupt/Effectively Bankrupt Borrowers, Potentially Bankrupt Borrowers, Substandard Borrowers, and Borrowers Requiring Caution: The proportion of each category's total unsecured claims covered by reserve for possible loan losses.

4. Reserve ratios for claims to Normal Borrowers and Borrowers Requiring Caution (excluding claims to Substandard Borrowers): The proportion of each category's total claims covered by reserve for possible loan losses. The reserve ratio of unsecured claims to Borrowers Requiring Caution (excluding claims to Substandard Borrowers) is shown in brackets.

5. Reserve ratio = (Specific reserve + General reserve for substandard loans) ÷ (Bankrupt and quasi-bankrupt assets + Doubtful assets + Substandard loans – Portion secured by collateral, guarantee, etc.)

### Classification of Problem Assets Based on the Financial Reconstruction Law

Bankrupt and Quasi-Bankrupt Assets	This category is defined as the sum of assets to Bankrupt Borrowers and Effectively Bankrupt Borrowers as categorized by self-assessment, excluding Classification IV assets, which are fully written off. Classification III assets are fully covered by reserves, and Classification I and II assets, the collectible portion, are secured by collateral or guarantees, etc.
Doubtful Assets	This category is defined as the assets to Potentially Bankrupt Borrowers under self-assessment. Specific reserves are set aside for Classification III assets, and Classification I and II assets, the collectible portion, are secured by collateral or guarantees, etc.
Substandard Loans	This category is defined as the sum of the loans extended to Borrowers Requiring Caution under self-assessment. This category includes past due loans (three months or more) and restructured loans.
Normal Assets	This category is defined as the sum, as of the term-end, of loans, securities lending, foreign exchange, accrued interest, suspense payments, and customers' liabilities for acceptances and guarantees that are not included in the other three categories.

## 2. Risk-Monitored Loans

In addition to the disclosure of problem assets in accordance with the Financial Reconstruction Law, we separately disclose the balance of Risk-Monitored Loans in accordance with the Banking

Law. On a nonconsolidated basis, Risk-Monitored Loans amounted to ¥5,630.9 billion as of September 30, 2002, a ¥185.5 billion decrease compared with March 31, 2002. On a consolidated basis, Risk-Monitored Loans amounted to ¥6,235.3 billion.

### ■ Risk-Monitored Loans (September 30, 2002)

(Billions of yen)

	Nonconsolidated	Ratio to total loans	Compared with March 31, 2002	Consolidated	Ratio to total loans	Compared with March 31, 2002
Bankrupt loans	¥ 217.9	0.4%	¥ 22.2	¥ 249.9	0.4%	¥ 22.4
Non-accrual loans	2,766.1	4.7	(418.3)	3,116.4	5.0	(483.3)
Past due loans (3 months or more)	95.5	0.2	3.2	109.4	0.2	6.6
Restructured loans	2,551.4	4.3	207.4	2,759.6	4.4	205.3
Total	¥5,630.9	9.6%	¥(185.5)	¥6,235.3	10.0%	¥(249.0)
Amount of direct reduction	¥1,365.5			¥1,712.2		

### □ Problem Assets Based on the Financial Reconstruction Law, and Risk-Monitored Loans

Category of borrowers under self-assessment	Problem assets based on the Financial Reconstruction Law		Risk-monitored loans	
	Total loans	Other assets	Total loans	Other assets
Bankrupt Borrowers	Bankrupt and quasi-bankrupt assets		Bankrupt loans	(C)
Effectively Bankrupt Borrowers			Non-accrual loans	
Potentially Bankrupt Borrowers			Past due loans (3 months or more)	
Borrowers Requiring Caution	Substandard loans	(Normal assets)	Restructured loans	
Normal Borrowers				
	(A)		(B)	(C)

The disclosure of Risk-Monitored Loans corresponds exactly to the disclosure of problem assets based on the Financial Reconstruction Law, except for such non-loan assets as securities lending, foreign exchange, accrued interest, suspense payments, and customers' liabilities for acceptances and guarantees, which are not included in the Risk-Monitored Loans category.

Since overdue interest from borrowers classified under self-assessment as Potentially Bankrupt Borrowers, Effectively Bankrupt Borrowers, and Bankrupt Borrowers is, as a rule, not recorded as accrued interest, the amount is not included in the problem assets disclosed on the basis of the Financial Reconstruction Law.

### ■ Problem Assets, by Domicile of Borrowers (Nonconsolidated; September 30, 2002)

(Billions of yen)

	Financial Reconstruction Law Basis	Percentage	Risk-Monitored Loans	Percentage
Domestic	¥5,508.4	96.6%	¥5,453.9	96.9%
Overseas	194.7	3.4	177.0	3.1
Asia	91.5	1.6	86.2	1.5
Indonesia	32.2	0.6	32.2	0.5
Hong Kong	11.8	0.2	11.5	0.2
India	7.2	0.1	5.4	0.1
China	4.8	0.1	4.8	0.1
Others	35.5	0.6	32.3	0.6
North America	43.3	0.8	37.3	0.7
Central and South America	8.1	0.1	1.7	0.0
Western Europe	48.4	0.8	48.4	0.9
Eastern Europe	3.4	0.1	3.4	0.0
Total	¥5,703.1	100.0%	¥5,630.9	100.0%

Note: "Domestic" means the total for domestic branches, excluding the special account for international financial transactions. "Overseas" means the total for overseas branches, including the special account for international financial transactions. The above countries and areas are categorized by the obligor's domicile.

### ■ Problem Assets, by Type of Borrowers (Nonconsolidated; September 30, 2002)

(Billions of yen)

	Financial Reconstruction Law Basis	Percentage	Risk-Monitored Loans	Percentage
Domestic	¥5,508.4	96.6%	¥5,453.9	96.9%
Manufacturing	285.5	5.0	283.1	5.0
Agriculture, forestry, fishery and mining	5.7	0.1	5.6	0.1
Construction	1,100.2	19.3	1,083.3	19.3
Wholesale and retail	653.3	11.4	644.6	11.5
Finance and insurance	154.2	2.7	151.9	2.7
Real estate	1,988.8	34.9	1,983.3	35.2
Transportation, communications, and other public enterprises	61.0	1.1	61.0	1.1
Services	970.2	17.0	963.1	17.1
Municipalities	—	—	—	—
Others	289.5	5.1	278.0	4.9
Overseas	¥ 194.7	3.4%	¥ 177.0	3.1%
Public sector	11.6	0.2	11.6	0.2
Financial institutions	2.3	0.0	2.3	0.0
Commerce and industry	180.8	3.2	163.1	2.9
Others	—	—	—	—
Total	¥5,703.1	100.0%	¥5,630.9	100.0%

Note: "Domestic" means the total for domestic branches, excluding the special account for international financial transactions. "Overseas" means the total for overseas branches, including the special account for international financial transactions.

### Off-Balancing Problem Assets

Under the provisions of the Emergency Economic Package enacted in April 2001, we are publishing the results of measures taken for the off-balancing of problem assets, as well as the amount of assets that were newly classified as Bankrupt and Quasi-Bankrupt Assets or Doubtful Assets.

The Bank is firmly committed to dealing effectively with the issue of off-balancing problem assets. While claims of ¥545.7 billion were newly classified as Bankrupt and Quasi-Bankrupt Assets, and Doubtful Assets during the first half of fiscal 2002, SMBC off-balanced ¥953.2 billion in problem assets during the same period.

## ■ Term-End Balance of Bankrupt and Quasi-Bankrupt Assets, and Doubtful Assets (Nonconsolidated)

(Billions of yen)

	September 30, 2000	March 31, 2001	September 30, 2001	March 31, 2002	Off-balanced during first half of fiscal 2002	September 30, 2002
<b>(1) Problem assets existing prior to and during the first half of fiscal 2000</b>						
Bankrupt and quasi-bankrupt assets	¥ 621.7	¥ 472.7	¥ 376.9	¥ 281.1		¥ 238.2
Doubtful assets	2,567.9	1,353.1	1,049.2	843.4		656.9
Total	¥3,189.6 ①	¥1,825.8	¥1,426.1	¥1,124.5	¥(229.4)	¥ 895.1 ②
Total sum of off-balanced assets (②-①)						¥(2,294.5)
Total sum of assets for which measures regarded as off-balancing implemented (Note 1)						(165.5)
Total						¥(2,460.0)
<b>(2) Problem assets classified during the second half of fiscal 2000</b>						
Bankrupt and quasi-bankrupt assets		¥ 117.2	¥ 141.6	¥ 57.3		¥ 52.0
Doubtful assets		590.1	268.7	144.2		111.8
Total		¥ 707.3 ③	¥ 410.3	¥ 201.5	¥ (37.7)	¥ 163.8 ④
Total sum of off-balanced assets (④-③)						¥ (543.5)
Total sum of assets for which measures regarded as off-balancing implemented (Note 1)						(46.8)
Total						¥ (590.3)
<b>(3) Problem assets classified during the first half of fiscal 2001</b>						
Bankrupt and quasi-bankrupt assets			¥ 55.5	¥ 76.0		¥ 65.2
Doubtful assets			327.8	233.2		160.1
Total			¥ 383.3 ⑤	¥ 309.2	¥ (83.9)	¥ 225.3 ⑥
Total sum of off-balanced assets (⑥-⑤)						¥ (158.0)
Total sum of assets for which measures regarded as off-balancing implemented (Note 1)						(57.2)
Total						¥ (215.2)
<b>(4) Problem assets classified during the second half of fiscal 2001</b>						
Bankrupt and quasi-bankrupt assets				¥ 79.1		¥ 96.1
Doubtful assets				1,749.4		1,130.2
Total				¥1,828.5 ⑦	¥(602.2)	¥ 1,226.3 ⑧
Total sum of off-balanced assets (⑧-⑦)						¥ (602.2)
Total sum of assets for which measures regarded as off-balancing implemented (Note 1)						(97.2)
Total						¥ (699.4)
<b>(5) Problem assets newly classified during the first half of fiscal 2002</b>						
Bankrupt and quasi-bankrupt assets						¥ 63.3
Doubtful assets						482.4
Total						¥ 545.7
Total sum of assets for which measures regarded as off-balancing implemented (Note 1)						¥ (59.0)
<b>Total((1)+(2)+(3)+(4)+(5))</b>						
Bankrupt and quasi-bankrupt assets	¥ 621.7	¥ 589.9	¥ 574.0	¥ 493.5		¥ 514.8
Doubtful assets	2,567.9	1,943.1	1,645.7	2,970.2		2,541.4
Total	¥3,189.6	¥2,533.0	¥2,219.7	¥3,463.7	¥(953.2)	¥ 3,056.2

## ■ Breakdown of Off-Balancing (Nonconsolidated; September 30, 2002)

	Off-balanced during first half of fiscal 2002
Disposition by borrowers' liquidation (Note 2)	¥ (3.0)
Reconstructive disposition (Note 3)	(135.7)
Improvement in debtors' performance due to reconstructive disposition	(203.4)
Loan sales to market	(184.3)
Direct write-offs	18.8
Others	(445.6)
Collection/repayment, etc.	(174.1)
Improvement in debtors' performance	(271.5)
Total	¥(953.2)

Notes: 1. "Measures regarded as off-balancing" refers to claims of borrowers under legal and quasi-legal action, the splitting of corporate borrowers into "financially sound" and "financially unsound" companies, the direct reduction of smaller consumer and middle-market customer assets and placement of assets in trust with The Resolution and Collection Corporation (RCC), with the aim of corporate rehabilitation.

2. "Disposition by borrowers' liquidation" refers to the abandonment or write-off of loans involved in bankruptcy liquidation proceedings (bankruptcy or special liquidations).

3. "Reconstructive disposition" refers to the abandonment of loans involved in rehabilitative bankruptcy proceedings (corporate reorganization, civil rehabilitation, composition, and arrangement), loan forgiveness involving special mediation or other types of civil mediation, or loan forgiveness for restructuring involving a private reorganization.