LOOKING BACK AT FISCAL 1999

Last year, Sumitomo Bank built on the initiatives launched in fiscal 1998. Two goals drove these reforms: the need to increase profit and to rationalize the balance sheet. Significant progress can be reported on both fronts.

Strategic Initiatives

The Bank has overhauled its business to focus on three areas of strategic importance: consumer banking, banking for the middle markets and capital markets/investment banking. This focus was dictated by the imperatives of capital efficiency and profitability, which imply increasing concentration of managerial and other resources on those areas in which the Bank can achieve higher returns.

Since April 1999, the Bank has embraced a profit-driven, market-segmentation strategy in its consumer and middle market banking operations with a clean separation between retail and corporate services in the domestic market.

This separation of capacity has helped the Bank to improve service to customers, both retail and corporate, by allowing it to address the specific needs of each market segment. At the same time, the Bank has restructured its range of products and services with an eye to promoting a steady stream of higher value-added, fee-based income.

In consumer banking, these include the distribution of investment products and investment advisory services where Sumitomo ranks among the market leaders. Distribution of investment trusts is an important strategic focus for the Bank. A secondary area of interest is the retail securities market in light of the synergies achievable with its other operations. In the on-line brokerage field, the Bank, in concert with a group of major Japanese companies, agreed to form a joint venture with DLJ, one of America's most successful providers of on-line discount brokerage services, to create DLJ*direct* SFG Securities.

In the middle markets, the Bank is building on its traditional businesses to offer its corporate customers practical solutions to their financial and operating requirements. As discussed later in the divisional reviews, this approach has already had a measurable effect on the Bank's performance.

Major Investment Projects Since Fiscal 1999

Consumer Banking Group	New branch terminal system (WIT), enhancement of telephone banking functions and establishment of additional centers, enhancement of Internet banking functions, enhancement of customer information file system, updating of ATMs
Middle Market Banking Group	Establishment of additional branches that specialize in receiving income fund transfers (virtual branches) only
International Banking Group	New international account system
Treasury Group	Systems for yen-denominated securities and money, currency dealing support system
Others	Settlement risk reduction system, credit risk management system, Internet settlement service, on-line debit service, adaptation to the Japanese version of 401K

One further strategic initiative introduced into the Bank's consumer and middle market banking operations was realized when the new E-Business Department was launched in October 1999. This Department has the mission of exploiting the full potential of new banking technologies, including the electronic settlement of accounts, as well as the organization of Sumitomo's response to all the main forms of e-business. The Bank's campaign to offer its customers high value-added in this area takes several forms.

For small and medium-sized corporate customers, the Bank focuses on helping them improve their sales activities and rationalize their administrative tasks. With this market in mind, it launched a portal site named "NETdeBIZ." For larger corporate customers, the Bank's mission is to help in providing e-banking services, such as electronic banking and account settlements. Meanwhile, for consumers, Sumitomo Bank has established its own electronic debit service, with plans for launching smart cards and electronic money well advanced. The Bank's goal is to provide consumers with banking services that satisfy their needs across all main demographic groups. To this end, it is pursuing appropriate business alliances and partnerships with companies in non-banking sectors, which can assist in the delivery of total Internet banking services.

Meanwhile, the establishment of Daiwa SBCM in April 1999 means that the Bank is now better positioned to offer services to the largest corporations in Japan with a powerful hybrid product range, drawing on strengths ranging from commercial to investment banking. Daiwa SBCM is now the principal platform for the Bank's capital market business. It offers assistance with conventional equity and debt transactions, while also giving the Bank access to superior services in such fields as M&A advisory services, IPOs, derivatives and structured finance.

The growth potential for the Bank's capital markets operations is very large and, consequently, promotion of these operations, with Daiwa SBCM as the flagship of this effort, is regarded as a priority. The Bank transferred the assets of its pre-existing securities subsidiary to Daiwa SBCM on the formation of that company. This allowed it to reallocate its capital in a more efficient way. In addition, several overseas operations were liquidated and the capital used therein recovered. The result has been a spectacular improvement in the return on investment of the capital markets business.

In April 2000, all the shares in SB Trust Bank Co., Ltd. (SB Trust), a wholly-owned trust banking subsidiary of Sumitomo Bank, were sold to the Sumitomo Trust and Banking Company Ltd. SB Trust will later be merged with Sumitomo Trust and Banking, which leads the trust banking industry in terms of scale and profitability. By concentrating trust-banking activities under the Sumitomo Trust and Banking roof, Sumitomo Bank will ensure that its customers have access to the huge resources of Japan's most successful and efficient trust bank.

Business Results

Reflecting the above initiatives, the Bank's business results improved during the past year. True, the Treasury Group found it difficult to maintain the high level of profits recorded in recent years, primarily because benefits accruing in the Japanese Government Bond (JGB) market from the low interest regime began to diminish. However, the four marketing groups - the Consumer Banking Group, the Middle Market Banking Group, the Corporate Banking Group, and the International Banking Group - collectively recorded healthy increases in profits.

In March 1999, Sumitomo Bank applied to the Financial Reconstruction Commission for approval to issue convertible preferred shares underwritten with public funds by the Resolution and Collection Bank, Ltd. Approval was granted for the Bank to issue 501 billion yen in convertible preferred shares. This was the second flotation by the Bank. In March of 1998, 100 billion yen in perpetual subordinated bonds were issued.

In connection with this application, Sumitomo Bank submitted a detailed recovery plan to the public authorities. At the close of fiscal 1999, almost all of the various interim goals that were set in the plan had been achieved.

Initial targets called for the achievement of core banking profits, excluding net transfer to general reserves, of 310 billion yen and net income of 75 billion yen in fiscal 1999. In the event, total core banking profits emerged at 389.4 billion yen and net income at 48.8 billion yen. The more or less sudden imposition of what is regarded by many observers as a tax on banking by the Tokyo Metropolitan Government is the main reason for the shortfall in net profits as the Bank was forced to incur a deferred tax charge of some 34.3 billion yen. But for the untimely imposition of this unprecedented tax measure, Sumitomo Bank would have amply exceeded its recovery-plan target for net profit in fiscal 1999.

By March 2000, the Bank intended, under the terms of its recovery plan, to reduce employee numbers to 14,400, the number of domestic branches to 276 and the number of overseas branches to 16. The outturn was that employee numbers were cut to 14,394, domestic branches to 277 and overseas branches to 18.

In addition to these reductions in staffing levels and branch numbers, employee bonuses have been reduced, operating and general (non-personnel) expenses have been squeezed, and a program of widespread cost reductions imposed. A program of business process re-engineering has yielded several benefits, including a fall in procurement costs from outside vendors. As a result, total expenses fell to 329.8 billion yen. This means that the Bank's commitment to shrink total expenses to 340 billion yen by fiscal 2002 has already been exceeded.

The above improvements to the Bank's cost-structure reduced its expenses to revenues ratio (excluding net transfer to the general reserves and gains/losses from the bond portfolio) by a full 5 percentage points to 45.4%.

This was complemented by a stronger performance by consolidated companies, which increased their contribution to consolidated operating profits to more than 60 billion yen.

Sumitomo Bank pledged to increase its loans on an actual basis (that is, after adjustment for write-offs, loan sales and other special factors) to the small and medium-sized company sector by 300 billion yen during fiscal 1999. In reality, the Bank managed to increase lending to this sector by 437 billion yen and thus exceeded the expectations of the public authorities in meeting the loan needs of financially sound small and medium-sized companies.

Asset Quality

To ensure that the new bank begins life with the lowest possible credit costs, Sumitomo Bank and Sakura Bank decided simultaneously to proceed to apply a tough new approach to problem assets. Sumitomo Bank decided on a two-year program with the main cuts to come in the first year, during fiscal 1999. The disposal of doubtful loans was accelerated through a program of aggressive write-offs. At the same time, in a further move designed to improve the quality of its balance sheet, the Bank took the precautionary move of reclassifying certain customers previously recorded as "requiring caution" to "potentially bankrupt." As a consequence, 681 billion yen in credit costs were incurred during fiscal 1999, a figure greatly in excess of initial forecasts.

Progress under Financial Restructuring Plan - Total Expenses
(*Billions of yen*)