ASSET QUALITY

1. The Impact of Self-Assessment

The System of Self-Assessment

Along with the implementation of Prompt Corrective Action legislation by the Japanese Government in April 1998, financial institutions started “Self-Assessment,” which requires individual banks to take responsibility for analyzing the quality of the assets of each of their borrowers based upon each bank’s criteria, and to classify their borrowers into five categories: “Normal Customers,” “Customers Requiring Caution,” “Potentially Bankrupt Customers,” “Virtually Bankrupt Customers” and “Bankrupt Customers.” Banks are further required to assess, on a scale of I to IV, the degree to which collection or value is compromised for each credit, to classify them accordingly and to make the appropriate write-offs and loan-loss provisions.

Implementation

Since the system of self-assessment was introduced in April 1998, Sumitomo Bank has systematically applied these criteria both to its credit assets and to other assets, including securities, movables, real estate, etc. As of the end of fiscal 1999, Sumitomo Bank’s total nonconsolidated assets totaled 51 trillion yen. Of this total, 3 trillion yen was in cash, deposits and other assets deemed to be immune to loss. The remaining sum of 48 trillion yen was subject to self-assessment.

In a refinement to the self-assessment system, a variety of broad risk classifications or categories has been designed in which borrowers can be assessed on the basis of their size, soundness and creditworthiness. The initial application of these criteria is conducted by a branch or business unit. These assessments are then subject to thorough review by the Credit Supervision Department (or the Credit Department in charge). The results of the assessment process are audited by the Credit Review Department, a wholly independent unit, to verify that assessment is in accordance with the criteria.

Also, in view of the Bank’s desire to strengthen the total risk management position of the Sumitomo Bank Group, the self-assessment process has also been basically applied to the Bank’s consolidated subsidiaries from fiscal 1998.

2. Write-offs and Reserves

Write-offs and reserves are based on the results of semi-annual self-assessments in accordance with the Financial Services Agency’s Financial Inspection Manual, guidelines issued by the Japan Institute of Certified Public Accountants, and guidelines by the Financial Reconstruction Commission. In order to strengthen the group basis of the risk management for the Bank, appropriate rules for write-offs and reserves are set for our consolidated domestic subsidiaries in accordance with the Bank’s rules.

Bankrupt Customers and Virtually Bankrupt Customers

Basically, the Bank fully writes-off individual borrowers classified as IV (considered to be uncollectible or to have become valueless). In addition to such measures, reserves have been established for possible loan losses against all Classification III credit assets.

Potentially Bankrupt Customers

The Bank establishes specific reserves for possible loan losses that are needed on the portion of Classification III credit assets unsecured by collateral or guarantees, as classified according to individual borrowers.

Customers Requiring Caution and Normal Customers

The Bank establishes lump-sum general reserves for possible loan losses against the credit balance of each credit group based on historical credit loss ratios, rather than executing write-offs and reserves according to each borrower.

Specifically, Customers Requiring Caution, except for those whose full credit amount is not classified under any other categories, are further sub-divided into groups according to default risk, and reserves are allocated on the basis of each group's reserve ratios. Borrowers are divided into credit groups, either "Substandard Assets" (Note) or "Others" which is further sub-divided into three sub-groups based on such factors as the borrower's financial condition and credit rating.

The reserve ratio for "Substandard Assets" is 15% of the total amount of claims, including the portion secured by collateral or guarantees. Then, reserve ratios for the other three sub-groups are calculated by factorizing delinquency, based on the actual historical credit loss ratio of each group. The average reserve ratio of the three sub-groups is 3.0%.

For the Customers Requiring Caution category with no classification and Normal Customers, the Bank accounts for anticipated losses over a 12-month period, based on the credit loss ratio determined from actual historical credit loss amount and other factors, under the general reserves for possible loan losses. The reserve ratio for this category is 0.3%.

Note: "Loans Past Due for Three Months or More" or "Restructured Loans" are individually classed as "Substandard Loans," one of the definitions stipulated by the "The Law Concerning Emergency Measures for the Revitalization of the Functions of the Financial System." The full or part amounts of all loans to "Substandard Loans" are regarded as "Substandard Assets" and are subject to provisions.

3. Write-offs and Provisions for Fiscal 1999

As of March 31, 2000, the total balance of credit cost was 680.7 billion yen. In addition to write-offs and reserve provisions in response to asset deterioration resulting from the ongoing economic downturn and the decline in land prices, the total also reflects the Bank's accelerated disposal process in preparation for the merger with Sakura Bank.

The total credit cost consists of 347.4 billion yen in write-offs, 253.0 billion yen in net provisions for specific reserves, and 38.8 billion yen in net provision for general reserves, together with a 25.0 billion yen loss on loans sold to the Cooperative Credit Purchase Corporation, a 19.6 billion yen loss on sale of delinquent credit assets, and a 3.1 billion yen reversal from the loan reserve for specific overseas countries. As a result of these measures, the total balance of loan-loss reserves was 909.0 billion yen.

The direct reduction, as of March 31, 2000, totaled 731.0 billion yen, which is a large increase from the 385.6 billion yen of the preceding fiscal year. The increase reflects an accelerated disposal process by the inclusion of customers with high credit risk in Virtually Bankrupt Customers.

Total credit costs on a consolidated base amounted to 733.5 billion yen, as of March 31, 2000. This brought the total balance of loan-loss reserves to 950.5 billion yen.

Credit Costs Including General Reserves

(*Billions of yen*)

Write-off of Loans	347.4
Net Provision for Specific Reserve	253.0
Net Provision for General Reserve (Note)	38.8
Others	41.5
Total Credit Cost (Nonconsolidated)	**680.7**
Total Credit Cost (Consolidated)	**733.5**

Note: As shown under core banking profit

4. Disclosure of Problem Assets

Under "The Law Concerning Emergency Measures for the Revitalization of the Functions of the Financial System" (the Revitalization Law), banks are to classify assets into one of four categories, and to disclose the corresponding total under each category. The four categories are Bankrupt and Quasi-bankrupt Assets, Doubtful Assets, Substandard Assets, and Normal Assets.

As of March 31, 2000, total disclosed assets of the Bank, other than Normal Assets, amounted to 1,917 billion yen. Although there were negative factors such as an increase in customers who went bankrupt or suffered financial difficulties, there was a 96.7 billion yen reduction compared with March 31, 1999, achieved by accelerating problem asset resolution in preparation for the merger with Sakura Bank.

In order to minimize credit costs following the merger, the Bank categorized customers who have a relatively high risk of future losses as Virtually Bankrupt Customers, made full reserve for the portion of loans not secured by collateral or guarantees, and made application of direct reductions. On the other hand, the Bank evaluated customer business plans more conservatively in view of the ongoing economic recession, and categorized, as a precautionary measure, such customers as Potentially Bankrupt Customers.

The average reserve ratio for disclosed loans, which were not secured by collateral or guarantees, etc., was 45.5%, a 15.3% reduction compared with the position as of March 31, 1999. This is because the ratio of customers with relatively low risk of default increased. The Bank considers this reserve level to be adequate.

Bankrupt and Quasi-bankrupt Assets: 190.8 billion yen (a 26.5 billion yen decrease from March 31, 1999)

This category is defined as the sum of credits to Bankrupt and Virtually Bankrupt Customers as categorized by self-assessment, minus fully written-off Classification IV credits. In addition, as all Classification III credits are fully covered by reserves, the remainder consists of the collective portion of credits secured by collateral or guarantees.

Note: All Classification IV credits are directly written-off using the direct reduction method even if the credits were not classified as tax-free write-offs.
This amount was 731.0 billion yen as of March 31, 2000.

Doubtful Assets: 1,351.2 billion yen (a 125.1 billion yen decrease from March 31, 1999)

This is the sum of Doubtful Assets extended to customers classified as Potentially Bankrupt under the self-assessment system. Since the sum includes credits that are secured by collateral or guarantees, and considered to be collectible assets, specific reserves are set aside for the unsecured portions under Classification III. The average reserve ratio for Classification III assets is 55.1%.

Substandard Loans: 375 billion yen (a 54.9 billion yen increase from March 31, 1999)

This is the sum of the loans extended to those customers classified as Requiring Caution under the self-assessment system. This figure includes loans that are already past due by three months or more, or that have been restructured.

Normal Assets: 32,849.8 billion yen

This amount is the sum, as of March 31, 2000, of loans, securities lending, foreign exchange, accrued interest, advanced payments and customer liabilities for acceptances and guarantees that is not included in the other three asset categories. Normal Assets thus represent the sum of loans to Normal Customers and that portion of loans identified through self-assessment as Requiring Caution, but not classified as Substandard, and on which the risk of loan-losses is deemed relatively small.

Classification of Customers, Disclosure of Problem Assets, and Reserve Policy (Nonconsolidated)

(*Billions of yen*) (*Year-on-year change*)

Classification of Customers under Self-Assessment	"Revitalization Law" Standard	Secured / Unsecured	Assessment/Reserve Policy (Second Half of Fiscal1999)	Reserve (Reserve Ratio) (1)
Bankrupt Customers **Virtually Bankrupt Customers**	Bankrupt & Quasi Bankrupt 190.8 (①) Change from Mar. 99 -26.5	Secured 185.7 Unsecured 5.1	Assessment Policy: Assessment aiming at acceleration of disposal had resulted in upward shift of some borrowers from Potentially Bankrupt Customers to Virtually Bankrupt Customers. As result, direct reductions has increased. (Mar. 2000: 731.0 billion yen; Mar 99: 385.6 billion yen) Reserve Policy: 100% reserves provided for the unsecured portion.	8.3 (2) **(100%)** Specific Reserve
Potentially Bankrupt Customers	Doubtful 1,351.2 (②) Change from Mar. 99 - 125.1	Secured 388.6 Unsecured 962.6	Assessment Policy: By stricter assessment of restructuring plan of borrowers, precautionary shifts occurred among borrowers who may need long time to recover, i.e. from Customers Requiring Caution to Potentially Bankrupt Customers. Reserve Policy: Various reserve ratio applied to respective assets, based on their credit risk. As a result, assets with lower risks (which means lower reserve ratio) increased, mainly due to aforementioned factor.	530.8 (2) **(55.1%)**
Customers Requiring Caution	Substandard Loans 375.0 (③) Change from Mar. 99 + 54.9 Substandard Assets(3)	Portion secured by Guarantees and Collateral 33.4	Reserve Policy: 15% of entire exposure is covered by general reserves.	Reserve for Substandard Loans 56.3 **(15.0%)**
Normal Customers	Normal Assets 32,849.8		Reserve Policy: Reserve based on historical credit loss ratio according to the classification in Self-Assessment. Three reserve categories are applied to Customers Requiring Caution, considering each customer's financial position, credit history, and credit ratings.	Average **(3.0%)** **(0.3%)** Total General Reserve 357.6
			Loan Loss Reserve for Specific Overseas Countries	12.3
	Total **34,766.8**		**Total Reserve for Possible Loan Losses** Ⓑ Reserve for "Revitalization Law" Assets (4)	**909.0** 595.4
	Ⓐ = ① + ② + ③ 1,917.0 Change from Mar. 99 - 96.7	Ⓒ Portion secured by Guarantees and Collateral 607.7	Ⓓ Unsecured Portion 1,309.3	
			(Ⓑ/Ⓓ) 45.5% Change from 3/99 -15.3%	

1 The reserve ratio shows the degree of reserve coverage against the total amount of each classification, except the reserve ratio with respect to "Bankrupt and Quasi-Bankrupt" and "Doubtful," which provide reserve coverage against the unsecured portion of those classifications.

2 Includes reserves for on-balance and off-balance sheet assets, which do not fall under the "Revitalization Law" disclosure standards. (Bankrupt/Virtually Bankrupt Customers: 3.2 billion yen. Potentially Bankrupt Customers: 5.7 billion yen)

3 "Substandard Loans" are classified on a loan by loan basis. If loans to a customer are classified as "Substandard Loans," the customer is categorized as "Substandard Assets." 15% of entire exposure to "Substandard Assets" is covered by General Reserve.

4 Sum of specific reserves and general reserve for Substandard Loans.

5. Disclosure of Risk-Monitored Loans

In addition to the problem assets disclosed under the Revitalization Law, the Bank also discloses problem assets classified as "Risk-Monitored Loans" under a proprietary standard based on U.S. disclosure criteria. As of March 31, 2000, Risk-Monitored Loans totaled 1,884.1 billion yen, a decrease of 75.8 billion yen compared with the figure for March 31, 1999.

The Bank accounts for accrued interest in real terms based on self-assessment results, rather than under the Tax Law standard. This approach shows more clearly how self-assessment results relate to assets disclosed under the Revitalization Law and Risk-Monitored Loans. Risk-Monitored Loans are basically the same as problem assets disclosed under the Revitalization Law, except that the items disclosed as Risk-Monitored Loans do not include credits other than loans, such as foreign exchange or advanced payments, etc. (32.9 billion yen).

On a consolidated basis, Risk-Monitored Loans totaled 2,203.3 billion yen, a decrease of 137.3 billion yen from the total as of March 31, 1999.

Notes: The Risk-Monitored Loans classification is based on Banking Law Implementation Regulations.
Refer to charts on pages 28, 29 and 30.

6. Credit and Reserve Policy in Overseas Exposure

As of March 31, 2000, Sumitomo Bank's exposure on a transfer risk basis to overseas countries and territories stood at \$31.9 billion (3,386.9 billion yen). Of this amount, exposure in North America and Western Europe accounted for two-thirds, while that in emerging markets made up the balance. The fact that nearly 70% of our exposure in emerging markets was in Asia demonstrates the continuing strategic importance of this market to the Bank.

Since fiscal 1997, reserves have been set aside in respect of both regional credit risk and individual country risk in response to recent Asian economic crisis. Both self-assessment of asset quality and probable reserve needs influenced this calculation. However, with the recovery of Asia's economies, including a broad return to growth, the need for special reserve requirements all but disappeared by the end of fiscal 1999. At the same time, the necessary cycle of problem asset assessment has also been satisfactorily completed.

Total reserves committed to cover the Bank's Asian exposure stand at \$460 million. As total exposure is \$9.3 billion, the average reserve ratio is 4.9%, roughly the same as last year. However, it should be noted that, in addition to this general provision, the Bank maintains a reserve ratio of 33.2% in the case of Indonesia.

Note: Refer to chart on page 31.

Differences Between the "Revitalization Law" and "Risk-Monitored Loans"

(Billions of yen)

Self-Assessment Standard	"Revitalization Law" Standard (Total Loans)	(Other Credits)	"Risk-Monitored Loans" (Percentage of Total Loans) (Total Loans)	(Other Credits)
Bankrupt Customers	Bankrupt & Quasi-Bankrupt Assets 190.8		Bankrupt Loans 73.0 (0.2%)	
Virtually Bankrupt Customers			Nonaccrual Loans 1,436.1 (4.6%)	
Potentially Bankrupt Customers	Doubtful Assets 1,351.2			**32.9**
Customers Requiring Caution	Substandard Loans 375.0		Past Due for Three Months or More 40.3 (0.1%)	
			Restructured Loans 334.7 (1.1%)	
Normal Customers	(Normal Assets)			
	Total (Excluding Normal Assets) **1,917.0**	**-**	**Total** **=** **1,884.1 (6.0%)**	**Difference** **32.9**

Each amount has been subject to direct reduction as described below.
Assets disclosed under "Revitalization Law": 731.0 billion yen, Risk-Monitored Loans: 705.8 billion yen

Significant Difference between "Revitalization Law" Standard and "Risk-Monitored Loans"

1 Disclosed amounts under the "Revitalization Law" standard include loans, securities lending, foreign exchange, accrued interest, and customers liabilities for acceptances and guarantees. (As an exception, amounts of "Substandard Loans" are only loans.) Disclosed amounts of "Risk-Monitored Loans" represent only loan.

2 Problem assets under the "Revitalization Law" standard are categorized by each borrower. (As an exception, "Substandard Loans" are assessed by each lending project.) "Risk-monitored Loans" are categorized through assessment by each lending project. However, from March 31, 1999, the Bank changed the accounting method for nonaccrual loans. Consequently, disclosed amount of "Risk-Monitored Loans," excluding "Past Due for Three Months or More" and "Restructured Loans" which are correspondents to "Substandard Loans" based on the "Revitalization Law" standard is equal to the amount through assessment by each borrowers. Therefore, major difference between the "Revitalization" standard and "Risk-Monitored Loans" are those mentioned above in 1.

Additional Notes for "Risk-Monitored Loans"

1 As a result, the Bank classified loans to "Bankrupt Customers" , "Virtually Bankrupt Customers" and "Potentially Bankrupt Customers" under the self-assessment standard as nonaccrual loans. Therefore, amounts of "Bankrupt Loans" and "Nonaccrual Loans," under the "Risk-Monitored Loans" standard, are equal to the amounts of loans to "Bankrupt Customers," "Virtually Bankrupt Customers" and "Potentially Bankrupt Customers" under the self-assessment standard. Amounts of Past Due for Three Months or More and "Restructured Loans" classified as "Risk-Monitored Loans" are equal to the amounts of "Substandard Loans" under the "Revitalization Law" standard, and is also, a portion of the loans to "Customers Requiring Caution" under the self-assessment standard.

Comparison Between Consolidated and Nonconsolidated Basis

1- “Risk -Monitored Loans”

(Billions of yen, %)

	Consolidated			Nonconsolidated		
	Total	Percentage of Total Loans	Change from Mar. 31, 1999	Total	Percentage of Total Loans	Change from Mar. 31, 1999
Bankrupt Loans	87.3	(0.3%)	- 121.0	73.0	(0.2%)	- 42.5
Nonacrual Loans	1,661.9	(5.0%)	- 16.5	14,36.1	(4.6%)	- 88.2
Past Due for Three Months or More	79.2	(0.2%)	- 91.7	40.3	(0.1%)	- 42.1
Restructured Loans	374.9	(1.1%)	91.9	334.7	(1.1%)	97.0
Total Risk-Monitored Loans (a)	**2,203.3** (1)	**(6.7%)**	**- 137.3**	**1,884.1** (2)	**(6.0%)**	**- 75.8**

1 After direct reduction of 931.1 billion yen.
2 After direct reduction of 705.8 billion.

2- Reserves for Possible Loan Losses

(Billions of yen, %)

	Consolidated	Nonconsolidated
General Reserves	365.4	357.6
Specific Reserves	572.7	539.1
Loan Loss Reserve for Specific Overseas Countries	12.4	12.3
Reserve for Possible Loan Losses (b)	**950.5**	**909.0**
Reserve Ratio (b)/(a)	**43.1%**	**48.2%**

Problem Assets by Domicile of Borrower (Nonconsolidated)

(Billions of yen, %)

	"Revitalization Law" Standard (Percentage of the Total)		"Risk Monitored Loans" (Percentage of the Total)	
Domestic	1,824.8	(95.2%)	1,801.2	(95.6%)
Overseas	92.2	(4.8%)	82.9	(4.4%)
Asia	72.0	(3.8%)	67.1	(3.6%)
Indonesia	25.8	(1.4%)	25.1	(1.3%)
China	14.7	(0.8%)	13.8	(0.7%)
Thailand	9.9	(0.5%)	8.4	(0.5%)
Hong Kong	14.1	(0.7%)	12.4	(0.7%)
Other	7.5	(0.4%)	7.4	(0.4%)
North America	16.3	(0.8%)	12.5	(0.6%)
Central and South America	1.3	(0.1%)	1.3	(0.1%)
Western Europe	0.4	(0.0%)	0.4	(0.0%)
Eastern Europe	2.2	(0.1%)	1.6	(0.1%)
Middle East/Africa	-	(-)	-	(-)
Total	**1,917.0**	**(100.0%)**	**1,884.1**	**(100.0%)**

The above countries and territories are categorized by the obligor's domicile.

Problem Assets by Domicile and Type of Borrower (Nonconsolidated)

(Billions of yen, %)

	"Revitalization Law" Standard (Percentage of the Total)		"Risk Monitored Loans" (Percentage of the Total)	
Domestic	1,824.8	(100.0%)	1,801.2	(100.0%)
Manufacturing	58.8	(3.2%)	58.3	(3.2%)
Agriculture, Forestry and Fishery	1.9	(0.1%)	1.9	(0.1%)
Construction	265.1	(14.5%)	265.0	(14.7%)
Wholesale and Retail Trade	167.6	(9.2%)	164.4	(9.1%)
Financial Institutions	101.8	(5.6%)	92.8	(5.2%)
Real Estate	578.8	(31.7%)	577.8	(32.1%)
Transportation, Communications and Other Public Enterprises	13.5	(0.8%)	13.5	(0.8%)
Services	604.5	(33.1%)	594.8	(33.0%)
Municipalities	-	(-)	-	(-)
Other	32.8	(1.8%)	32.7	(1.8%)
Overseas	92.2		82.9	
Public Sector	-		-	
Financial Institutions	2.8		2.6	
Commerce and Industry	89.4		80.3	
Other	-		-	
Total	**1,917.0**		**1,884.1**	

Overseas Exposure and Reserves (Nonconsolidated)

(Millions of U.S. dollars, %)

	Total Exposure (Transfer Risk Basis) ①	Sovereign	Japanese Institutions	Non-Japanese Institutions	Financial Institutions	Reserves ②	Reserve Ratio ②/①
Total	**3,1907**	**4,305**	**8,838**	**14,340**	**4,424**	**565**	**1.8**
Asia	**9,286**	**1,457**	**1,942**	**4,853**	**1,034**	**456**	**4.9**
Hong Kong	2,247	87	332	1,794	34	26	1.2
China	1,433	696	527	196	14	87	6.1
South Korea	1,364	0	4	764	596	6	0.4
Singapore	1,212	215	551	369	77	5	0.4
Thailand	990	140	273	477	100	40	4.0
Indonesia	771	83	121	475	92	256	33.2
Malaysia	517	123	121	266	7	16	3.1
Taiwan	396	7	0	303	86	10	2.5
India	286	92	12	175	7	5	1.7
Philippines	65	13	1	34	17	0	0.0
Central and South America	**833**	**95**	**354**	**140**	**244**	**6**	**0.7**
Brazil	527	1	314	12	200	1	0.2
Mexico	75	20	0	28	27	4	5.3
Eastern Europe	**377**	**151**	**0**	**190**	**36**	**19**	**5.0**
Slovakia	107	69	0	37	1	11	10.3
Hungary	42	4	0	28	10	0	0.0
Russia	6	0	0	6	0	6	100.0
North America	**10,688**	**929**	**3,192**	**5,638**	**929**	**48**	**0.4**
Western Europe	**8,572**	**1,331**	**2,472**	**3,053**	**1,716**	**21**	**0.2**
Others	**2,151**	**342**	**878**	**466**	**465**	**15**	**0.7**

1 "Transfer Risk" is defined as exposures classified by region based on the place where the risks are actually taken.
For example, exposures guaranteed by the Japanese parent company are considered as exposures to Japan.

2 The figures include loans, bonds, call loans and customer's liabilities for acceptances and guarantees. Outstanding balance of exposures is counted.

3 "Reserves" consist of specific reserve, loan loss reserve for specified countries and general reserve (including additional loan loss reserve for Asian countries).

4 All of the figures are after direct reduction (US$323 million in total).