

# ASSET QUALITY

## 1. Self-Assessment

Sumitomo Bank has conducted a self-assessment of overall assets, including credit assets and such other assets as securities, movables and real estate. As of September 30, 2000, Sumitomo Bank's total nonconsolidated assets amounted to ¥53 trillion. Of this total, ¥2 trillion was in cash, deposits and other assets deemed to involve no impairment risk. The remaining ¥51 trillion was subject to self-assessment.

In self-assessment, borrowers are selected by a variety of criteria, including financial condition and credit grade. Selected borrowers are categorized into five categories according to each customer's situation: "Normal Customers," "Customers Requiring Caution," "Potentially Bankrupt Customers," "Virtually Bankrupt Customers" and "Bankrupt Customers." Furthermore, their assets are classified on a scale of I to IV, according to the degree of repayment risk or impairment risk. A business unit first conducts a "primary assessment" of credit assets, and then the credit department in charge does a "second assessment." Other assets are assessed by the department in charge. To verify that the assessments accord with set criteria, the results are audited by the Credit Review Department, a wholly independent unit.

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 applied to the Bank's consolidated subsidiaries.

## 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 and guidelines issued by the Japan Institute of Certified Public Accountants, etc.

In order to strengthen the total risk management position of the Sumitomo Bank Group, appropriate rules for write-offs and reserves for the Bank's consolidated subsidiaries are consistent with internal regulations.

### **Bankrupt Customers and Virtually Bankrupt Customers**

The Bank fundamentally writes-off the full amount of Classification IV assets (deemed to be uncollectible or of no value) that are individually calculated by borrower. In addition, specific reserves have been set for possible loan losses against the full amount of Classification III assets.

### **Potentially Bankrupt Customers**

The Bank sets specific reserves for possible loan losses on the portion of Classification III assets (other than those expected to be collectible by collateral or guarantees, etc.), as classified according to individual borrowers.

### **Customers Requiring Caution and Normal Customers**

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

Customers Requiring Caution are further subdivided into groups according to default risk, and a different reserve ratio is adopted for each subgroup. Borrowers are divided primarily into credit groups, either "Substandard Assets" (see note below) or "Others," which are further subdivided into three subgroups based on such factors as the borrower's performance and credit grade.

The reserve ratio for Substandard Assets is 15% of the total amount of the claims, including the portion secured by collateral or guarantees, etc. Reserve ratios for the three subgroups are then calculated by considering delinquency, based on the historical loss ratio of each group. The average reserve ratio of the three subgroups is 2.1%.

For Normal Customers (including Customers Requiring Caution not having classified assets), the Bank accounts for expected losses over a 12-month period, based on the historical loss ratio determined from the historical loss. The average reserve ratio is 0.2%.

*Note: "Substandard Loans," one of the loan categories set forth in the Law Concerning Emergency Measures for the Revitalization of the Functions of the Financial System (the "Revitalization Law"), are loans to Customers Requiring Caution, that are three months or more past due, or that are restructured. Substandard Assets are the overall credits to borrowers whose loans are entirely or partially classified as Substandard Loans. The Bank has sets reserves for Substandard Assets.*

### 3. Write-offs and Provisions

For the six-month period ended September 30, 2000, total credit cost, including general reserves, amounted to ¥199.3 billion on a nonconsolidated basis. This reflects the Bank's final disposal process in preparation for the merger with Sakura Bank, as well as in response to asset deterioration resulting from ongoing bankruptcies and the decline in real estate prices.

Total credit cost consists of ¥54.5 billion in write-offs of loans, ¥266.5 billion in net provisions for specific reserves, ¥4.3 billion in losses on loans sold to the Cooperative Credit Purchase Co., Ltd., and ¥3.1 billion in losses on sale of delinquent credit assets, as well as a ¥127.9 billion net reversal from general reserves and ¥0.7 billion net reversal from the loan reserve for specific overseas countries. As a result, the reserve for possible loan losses totaled ¥958.8 billion.

As of September 30, 2000, the direct reduction was ¥763.3 billion, a ¥32.3 billion increase compared with March 31, 2000.

Total credit cost on a consolidated basis amounted to ¥228.1 billion, which brought the total reserve for possible loan losses to ¥1,013.6 billion.

#### ■ Credit Cost (Including General Reserves)

Six-month period ended September 30, 2000	Billions of Yen
Write-offs of loans	¥ 54.5
Net provisions for specific reserves	266.5
Net provisions for general reserves (Note)	(127.9)
Others	6.2
Total credit cost (nonconsolidated basis)	<u>¥199.3</u>
Total credit cost (consolidated statement of income basis)	<u>¥228.1</u>

*Note: Figures as recorded under core banking profit.*

#### 4. Disclosure of Problem Assets

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

As of September 30, 2000, total disclosed assets of the Bank, other than Normal Assets, amounted to ¥2,164.5 billion, a ¥247.5 billion increase compared with March 31, 2000.

**Bankrupt and Quasi-Bankrupt Assets:** ¥181.8 billion (¥9.0 billion decrease compared with March 31, 2000)

This category is defined as the sum of credits to customers categorized by the self-assessment as Bankrupt and Virtually Bankrupt, less fully written-off Classification IV assets (see note below) considered to be uncollectible or of no value. In addition, as all Classification III assets are fully covered by reserves, the remaining credits consist of the collectible portion of credits secured by collateral or guarantee.

*Note: All Classification IV assets are directly written-off using the direct reduction method, even if the assets were not classified as tax-free write-offs. This amount was ¥763.3 billion as of September 30, 2000.*

**Doubtful Assets:** ¥1,838.7 billion (¥487.5 billion increase compared with March 31, 2000)

This is the sum of Doubtful Assets extended to customers categorized as Potentially Bankrupt by the self-assessment. Specific reserves are set aside for Classification III assets, which are defined as the portion of assets that are not expected to be collectible by collateral or guarantees, etc. The average reserve ratio for Classification III is 64.2%.

**Substandard Loans:** ¥144.0 billion (¥231.0 billion decrease compared with March 31, 2000)

This is a part of credits extended to Customers Requiring Caution in the self-assessment. In other words, this is the sum of loans to Customers Requiring Caution that are three months or more past due, or that have been restructured.

**Normal Assets:** ¥32,987.9 billion

This amount is the sum of loans, securities lending, foreign exchange, accrued interest, provisional payments and customer liabilities for acceptances and guarantees, as of September 30, 2000, that are not included in the other three asset categories. Normal Assets, therefore, represent the sum of credits to Normal Customers and the portion of credits to Customers Requiring Caution, excluding Substandard Loans. The risk of loan losses is deemed to be relatively small.

■ **Comparison Between Self-Assessment, Disclosure of Problem Assets, and Write-offs/Reserves (Nonconsolidated)**

After Direct Reductions				
The accrued interests of loans extended to Potentially Bankrupt, Virtually Bankrupt and Bankrupt Customers are recognized as unearned.				
(Billions of Yen)				
Borrower's Self-Assessment Category	Revitalization Law Standard	Secured/Unsecured	Reserve Policy (First Half of Fiscal 2000)	Reserve (Reserve Ratio) (1)
Bankrupt Customers	Bankrupt and Quasi-Bankrupt Assets  181.8 (①) (Change from Mar. 31, 2000 –90)	Assets expected to be collectible by collateral or guarantees, etc. 178.5 (a)	Direct write-offs (Including direct reductions) or 100% reserves provided for the unsecured portion  *Direct reductions Sept. 30, 2000: ¥763.3 billion; Mar. 31, 2000: ¥731.0 billion	6.5 (2) (100%)
Virtually Bankrupt Customers		Other 3.3		Specific reserve
Potentially Bankrupt Customers	Doubtful Assets  1,838.7 (②) (Change from Mar. 31, 2000 +487.5)	Assets expected to be collectible by collateral or guarantees, etc. 731.7 (b)  Other 1,107.0	Specific reserves are set for possible loan losses that are needed on the portion of Classification III.	711.0 (2) (64.2%)
Customers Requiring Caution	Substandard Loans 144.0 (③) (Change from Mar. 31, 2000 –231.0)	Portion of Substandard Loans secured by collateral or guarantees, etc. 35.6 (c)	15% of entire exposure is covered by general reserve.	Reserve for Substandard Loans: 21.6 (15.0%)
	Substandard Assets (3)			Average (2.1%)
Normal Customers	Normal Assets  32,987.9		Reserve is based on the historical loss ratio according to the borrower's self-assessment category. For credits to Customers Requiring Caution (excluding Substandard Assets), reserve against the subgroups according to borrower's performance and credit grade.	(0.2%)
				Total general reserve 229.7
			Loan loss reserve for specific overseas countries	11.6
Total 35,152.4		Total reserves for possible loans		958.8
		⑤ Reserve for Revitalization Law		739.1
④ = ① + ② + ③ 2,164.5 (Change from Mar. 31, 2000 +247.5)		③ Assets expected to be collectible by collateral or guarantees, etc. ((a)+(b)+(c))) 945.8	① Other than ③ (④ – ③)	1,218.7
		⑥ / ① 60.6% (Change from Mar. 31, 2000 +15.1%)		

Notes: 1. The reserve ratio shows the degree of reserve coverage against the total amount of each category, except the reserve ratio with respect to Bankrupt and Quasi-Bankrupt Assets and Doubtful Assets, which provide reserve coverage against other credits than those expected to be collectible by collateral or guarantees, etc.

2. Includes reserves for on- and off-balance sheet assets, which do not fall under the Revitalization Law disclosure standards (Bankrupt/Virtually Bankrupt Customers: ¥3.2 billion, Potentially Bankrupt Customers: ¥7.2 billion).

3. Substandard Loans is the amount of loans classified into the classification, while Substandard Assets is the amount of the overall credits extended to borrowers whose loans are entirely or partially classified as 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” based on the Banking Law. As of September 30, 2000, Risk-Monitored Loans totaled ¥2,113.0 billion, an increase of ¥228.9 billion compared with March 31, 2000.

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

### ■ Differences between the Revitalization Law Standard and Risk-Monitored Loans

Borrower's Self-Assessment Category	Revitalization Law Standard		Risk-Monitored Loans (Percentage of Total Loans)	
	(Total Loans)	(Other Credits)	(Total Loans)	(Other Credits)
Bankrupt Customers	Bankrupt and Quasi-Bankrupt Assets 181.8		Bankrupt Loans 75.0 (0.2%)	51.5
Virtually Bankrupt Customers			Nonaccrual Loans 1,894.0 (6.0%)	
Potentially Bankrupt Customers			Three Months or More Past Due 24.9 (0.1%) Restructured Loans 119.1 (0.4%)	
Customers Requiring Caution	Doubtful Assets 1,838.7			
	Substandard Loans 144.0			
Normal Customers	(Normal Assets)			
Total (Excluding Normal Assets) 2,164.5		–	Total 2,113.0 (6.6%)	= Difference 51.5

Note: The amount of direct reduction is:  
The Revitalization Law standard = ¥763.3 billion;  
Risk-Monitored Loans = ¥744.6 billion.

#### Significant Differences 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 loans.
2. Problem assets under the Revitalization Law standard are categorized by each borrower. (As an exception, Substandard Loans are assessed by facility.) Risk-Monitored Loans are categorized through assessment by facility. However, from the fiscal year ended March 31, 1999, the Bank changed the accounting method for nonaccrual loans. Consequently, disclosed amounts of Risk-Monitored Loans, excluding past due for three months or more and restructured loans that correspond to Substandard Loans based on the Revitalization Law standard, are equal to the amounts through assessment by each borrower. Therefore, major differences between the Revitalization Law standard and Risk-Monitored Loans are those mentioned above in 1.

#### Additional Note for Risk-Monitored Loans

From the fiscal year ended March 31, 1999, the Bank changed the accounting method for nonaccrual loans from the Tax Law standard to the assessment standard. 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 three months or more past due and restructured loans classified as Risk-Monitored Loans are equal to the amounts of Substandard Loans under the Revitalization Law standard, and are 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

As of September 30, 2000	Billions of Yen, %					
	Consolidated			Nonconsolidated		
	Total	Percentage of Total Loans	Change from Mar. 31, 2000	Total	Percentage of Total Loans	Change from Mar. 31, 2000
Bankrupt loans	¥ 92.1	0.3%	¥ 4.8	¥ 75.0	0.2%	¥ 2.0
Nonaccrual loans	2,098.0	6.3	436.1	1,894.0	6.0	457.9
Past due three months or more	67.4	0.2	(11.8)	24.9	0.1	(15.4)
Restructured loans	165.1	0.5	(209.8)	119.1	0.4	(215.6)
Total Risk-Monitored Loans (a)	<u>¥2,422.6</u>	<u>7.3%</u>	<u>¥219.3</u>	<u>¥2,113.0</u>	<u>6.6%</u>	<u>¥228.9</u>
	(Note 1)			(Note 2)		

Notes: 1. After direct reduction of ¥970.0 billion.

2. After direct reduction of ¥744.6 billion.

### (2) Reserve for Possible Loan Losses

As of September 30, 2000	Billions of Yen	
	Consolidated	Nonconsolidated
General reserve	¥ 232.0	¥229.7
Specific reserve	769.9	717.5
Loan loss reserve for specific overseas countries	11.7	11.6
Total reserve for possible loan losses (b)	<u>¥1,013.6</u>	<u>¥958.8</u>
Reserve ratio (b)/(a)	41.8%	45.4%

## ■ Problem Assets by Domicile of Borrower (Nonconsolidated)

As of September 30, 2000	Billions of Yen, %			
	Revitalization Law Standard (Percentage of the Total)		Risk-Monitored Loans (Percentage of the Total)	
Domestic	¥2,080.6	(96.1%)	¥2,041.2	(96.6%)
Overseas	83.9	(3.9%)	71.8	(3.4%)
Asia	60.3	(2.8%)	51.4	(2.4%)
Indonesia	19.5	(0.9%)	19.5	(0.9%)
China	10.6	(0.5%)	9.0	(0.4%)
Thailand	9.3	(0.4%)	8.0	(0.4%)
Hong Kong	12.2	(0.6%)	7.8	(0.4%)
Other	8.7	(0.4%)	7.1	(0.3%)
North America	21.3	(1.0%)	18.2	(0.9%)
Central and South America	0.0	(0.0%)	0.0	(0.0%)
Western Europe	0.6	(0.0%)	0.6	(0.0%)
Eastern Europe	1.7	(0.1%)	1.6	(0.1%)
Middle East and Africa	—	(—)	—	(—)
Total	<u>¥2,164.5</u>	<u>(100.0%)</u>	<u>¥2,113.0</u>	<u>(100.0%)</u>

Note: The above countries and areas are categorized by the obligor's domicile.

## ■ Problem Assets by Domicile and Type of Borrower (Nonconsolidated)

As of September 30, 2000	Billions of Yen, %			
	Revitalization Law Standard (Percentage of the Total)		Risk-Monitored Loans (Percentage of the Total)	
Domestic	¥2,080.6	(100.0%)	¥2,041.2	(100.0%)
Manufacturing	63.3	(3.0%)	62.8	(3.1%)
Agriculture, forestry, fisheries and mining	3.9	(0.2%)	3.9	(0.2%)
Construction	571.2	(27.4%)	554.6	(27.2%)
Wholesale and retail	168.6	(8.1%)	165.9	(8.1%)
Finance and insurance	87.1	(4.2%)	78.0	(3.8%)
Real estate	504.7	(24.3%)	504.0	(24.7%)
Transportation, communications and other public enterprises	16.6	(0.8%)	16.5	(0.8%)
Services	636.3	(30.6%)	626.6	(30.7%)
Municipalities	—	(—)	—	(—)
Other	28.9	(1.4%)	28.9	(1.4%)
Overseas	83.9		71.8	
Public sector	—		—	
Financial institutions	7.5		7.4	
Commerce and industry	76.4		64.4	
Other	—		—	
Total	<u>¥2,164.5</u>		<u>¥2,113.0</u>	