Resolution of Problem Assets

Self-Assessment System

From April 1998, the Japanese government initiated a program of Prompt Corrective Action aimed at shoring up the nation's financial institutions. A cornerstone of this program is "self-assessment," whereby banks are required to analyze their assets borrower-by-borrower and 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 collectability or value is compromised for each customer, to classify them accordingly and to make the appropriate write-offs and loan-loss provisions.

Sumitomo Bank applies the self-assessment system to loans as well as other assets, such as marketable securities and real estate, office equipment and furniture, and other property. Of the Bank's ¥51 trillion in total nonconsolidated assets, ¥47 trillion was subject to self-assessment while ¥4 trillion was cash, deposits and other assets deemed to involve no risk of loss. Of the borrowers in the self-assessment category, some are further classified into various broad risk categories, such as borrowers with problematic financial conditions, large-sum borrowers and borrowers with low credit ratings. Loan officers at the branch and department level examine each of these in a primary assessment. A secondary assessment is conducted by the Credit Supervision Department. The assessment procedures are also audited by the Credit Review Department, which is a completely independent unit, to verify compliance with the self-assessment standards.

The number of companies included as consolidated subsidiaries increased substantially, in accord with new requirements under Japan's revised accounting standards effective from fiscal year 1998 onward. Also, in view of our desire to strengthen the total risk management position of the Sumitomo Bank Group, the self-assessment process is being introduced to our consolidated subsidiaries and in this fiscal year "risk-monitored loans" are disclosed on a consolidated basis.

Write-offs and Reserves

The methods for determining write-offs and reserve requirements have been revised, effective March 1999. As in the past, write-offs and reserves are still determined by semi-annual self-assessments. However, two major changes have been introduced as a result of the issue of a financial auditing manual by the Japanese Financial Supervisory Agency, revisions to guidelines issued by the Japan Institute of Certified Public Accountants, and the publication of guidelines for reserves by the Financial Reconstruction Commission.

First, to improve asset quality, Sumitomo Bank has increased its general reserves for possible loan losses applicable to "normal customers" and to "customers requiring caution." Second, we have raised the reserve ratio on loans to "potentially bankrupt customers." The rationale for these two changes is as follows. Although we certainly take appropriate write-offs and create sufficient reserves for bankrupt and quasi-bankrupt credit risks, we must also hold reserves against potential credit risks and take the most conservative financial measures to ensure the soundness of our assets. As a result, we believe our future credit costs will be largely reduced.

Regarding the increase of our general reserve, as mentioned above, we took the first step by adding ¥176.3 billion during fiscal year 1998, by raising the total reserve to ¥318.7 billion as of the year-end. This was a precautionary reserve against the possibility of any future asset impairment.

Specifically, to strengthen reserves for loans to customers requiring caution, these credit assets are divided into four groups according to default risk. Each group is then assigned a reserve ratio and corresponding provisions are transferred to reserves according to default risk. The first group consists of "substandard assets," as defined under the Revitalization Law (see Note following). The other three groups are distinguished by the financial condition and credit rating of the borrower, among other indicators. The actual historical default rate is calculated for each group and this rate is used to determine the reserve ratio for reserves.

The portions of credit assets of "potentially bankrupt customers" that are not secured by collateral or other guarantees are classified as the amount at risk of loss (Category III). Since default risk may increase over the short term, owing to the recent downturn of corporate earnings and ongoing deflation, we have taken the further precaution of applying an across-the-board reserve ratio of 70% to all groups within Category III. We have thereby effectively raised the average reserve ratio for this category, which had been set at 60% in the past, to 71.7%. The reserve ratio for all groupings classified as "bankrupt" and "virtually bankrupt" is 100%.

In fiscal year 1998, self-assessment and appropriate write-off and reserve provisions are applicable to subsidiaries included in the Consolidated Financial Statements.

Note: "Substandard assets," "Loans past due for three months or more" or "restructured loans" are individually classed as "substandard loans," one of the definitions stipulated by the Revitalization Law. The full amounts of all loans to "substandard assets" include the "substandard loans" category and are subject to assessment for provisions. Based on the Revitalization Law standards, it is not necessary to set a reserve at the 15% rate for this entire category, but only for the portion not secured by real estate or guarantees. Nevertheless, as a conservative measure, we have fixed our assessment rate for all assets in this category at 15%.

Fiscal Year 1998 Write-offs and Provisions

Based on the calculations produced by the self-assessments, a total of ¥1,072.4 billion was written off or transferred to reserves during the period. Of this amount, loan write-offs amounted to ¥305.0 billion, transfers to the specific reserve were ¥371.8 billion, losses on delinquent loans sold totaled ¥65.1 billion, losses on sales of loans to the Cooperative Credit Purchasing Co., Ltd., were ¥60.3 billion and transfers to the reserve for loss on loans sold came to ¥79.2 billion.

As described above, and as precautionary measures, new assessments were made against "customers requiring caution" and "normal customers," resulting in the balance of the reserve for possible loan losses being raised by ¥176.3 billion. Additionally, a provision was made to cover the heightening country risk of emerging markets, particularly Asian countries, in the form of a loan reserve for specific overseas countries of ¥14.7 billion against funds lent to debtors in the region. As a result of these measures, the total reserve for possible loan losses as of the end of fiscal year 1998 rose to ¥1,053 billion. On a consolidated basis, total credit costs came to ¥1,265.3 billion and the reserve for possible loan losses reached ¥1,267.9 billion at the fiscal year-end.

Disclosure of Problem Assets

1. New Disclosure Standards Set by the Revitalization Law

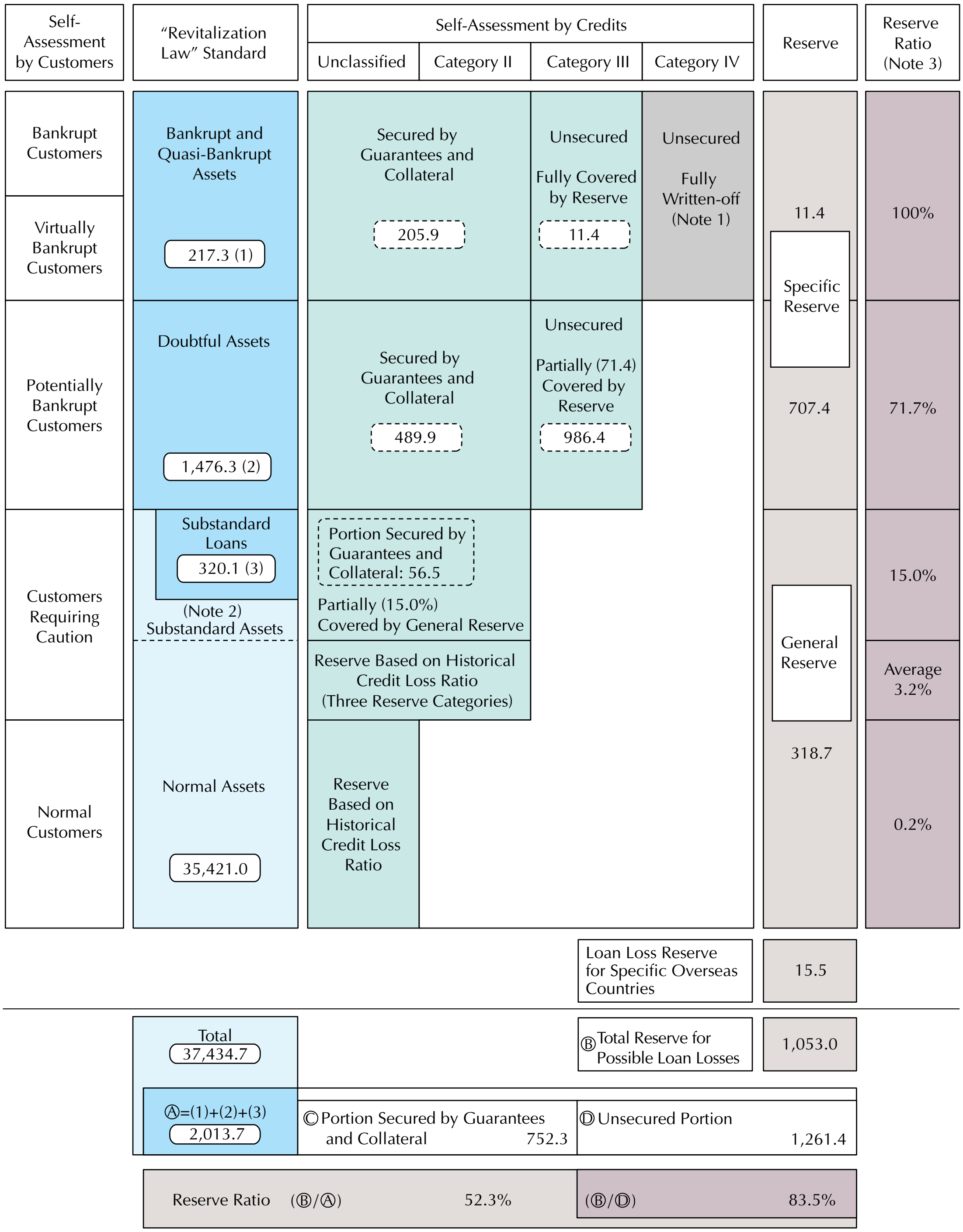
Effective March 31, 1999, under the Revitalization Law, banks classify assets in one of four categories and to disclose the corresponding amounts. The categories are "bankrupt and quasi-bankrupt assets," "doubtful assets," "substandard loans" and "normal assets." Each of these categories is explained below. Among the first three, excluding the portion which is secured by guarantees or collateral to cover problem assets, the reserve ratio has been increased 83.5%, which we regard as fully reserved.

Bankrupt and Quasi-Bankrupt Assets: ¥217.3 billion

Under the new standards, this is defined as the sum of credit assets to bankrupt and virtually bankrupt customers as categorized by self-assessment, minus Category IV credit assets fully written off. It is also equal to Category III credit assets which are fully covered by reserves, plus the collectible portion of credit assets which are secured. Under the accounting policy employed up until September 1998, credit assets that were not subject to tax-free write-offs were, in accordance with the Tax Law standards, not directly written off. Rather, specific reserves were set aside for the portions deemed uncollectible. As of fiscal year 1998, however, the accounting policy was changed so that all of Category IV credit assets are directly written-off (using the direct reduction method).

Self-Assessment Standard and Policy for Write-off and Reserves

(Billions of Yen)



Notes: 1. Direct reduction of ¥385.6 billion is included.
2. "Substandard loans" are classified on a loan by loan basis. If any loans to a customer are classified as "substandard loans," the customer is categorized as "substandard assets." 15% of general reserve is provided against entire assets for the "substandard assets."
3. 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 is the reserve coverage against the unsecured portion of those classifications.

Doubtful Assets: ¥1,476.3 billion

This is the sum of doubtful assets extended to customers classified as potentially bankrupt, under the self-assessment system. Since this sum includes the portions of credit assets that are secured with collateral or other guarantees and are thought to be collectible, specific reserves are set aside for the unsecured portions (Category III).

Substandard Loans: ¥320.1 billion

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

Normal Assets: ¥35,421.0 billion

This amount is the sum of the securities lending, loans, foreign exchange, accrued income, advance payments and customers' liabilities for acceptances and guarantees at March 31, 1999, that are not included in any of the "bankrupt or quasi-bankrupt assets," "doubtful assets" and "substandard loans" categories. Of the assets classified under the self-assessment system to be extended to "customers requiring caution," normal assets are those that are deemed to be those held by "normal customers" under the self-assessment standards and not "substandard loans." They are therefore considered to bear a low risk of default and to be collectible.

2. Disclosure of Risk-monitored Loans

Since fiscal year 1997, Sumitomo Bank has disclosed problem assets classified as "risk-monitored loans " separately from its disclosure based on the Revitalization Law. The total amount of "risk-monitored loans" at March 31, 1999, stood at ¥1,959.9 billion, an increase of ¥490.7 billion over a year earlier, which partly reflects the effect of a change in accounting policy from the end of the period. Specifically, the following two changes were made in accounting for risk-monitored loans.

Change to the Direct Reduction Method

From March 31, 1999, the direct reduction method has been used to write off credit assets (Category IV) that were identified through self-assessment as having no value or having no potential for collection. The change to this method accounted for a ¥341.9 billion decrease in the balance of risk-monitored loans.

Change in Accounting for Nonaccrual Loans

Prior to the change in accounting methods, nonaccrual loans disclosed as "risk-monitored loans" were classified as "loans to borrowers under legal bankruptcy procedures" or "nonaccrual loans." Under this Tax Law-approved method, unpaid interest was not included as income, only in case the borrowers were subject to external evidence of distress, such as legal bankruptcy or interest payments more than six months overdue.

Beginning in fiscal year 1999, the Bank will no longer adhere to the Tax Law method. Based on the principle that interest from loans thought to be highly unlikely for collection should not be included in income, we have adopted the uniform nonaccrual loan accounting method for loans to "bankrupt customers," "virtually bankrupt customers" and "potentially bankrupt customers," as classified in the self-assessment categories. Under the aforementioned accounting method, loans to customers in such categories that were not recognized as nonaccrual loans under the Tax Law, nor classified as "past due for three months or more" or as "restructured loans," were not subject to disclosure as risk-monitored loans. The inclusion of these loans under the new accounting method has the effect of raising risk-monitored loans by ¥1,006.2 billion.

In addition, among the loans classified under self-assessment as those extended to "potentially bankrupt customers," loans formerly disclosed as "past due for three months or more" or "restructured loans" that were not classified as nonaccrual loans under the Tax Law rules will all be treated as nonaccrual loans and disclosed as "nonaccrual loans" under the new method. The effect of this shift is ¥252.3 billion.

Accordingly, Japanese banks are required to adopt the new disclosure methods on a consolidated basis for the fiscal year ending March 31, 1999. The consolidated risk-monitored loans amounted to ¥2,340.6 billion, or ¥380.7 million more than reported on a nonconsolidated basis. This difference is mainly due to the increased number of non-bank subsidiaries, such as The Bank of Kansai, Ltd., SB Leasing Company, Limited, and others, for which new calculations apply under the new accounting rules. Consolidated subsidiaries have begun disposing of problem assets based upon self-assessment results. The consolidated reserve ratio at 54.2%, which is identical to the same ratio on a nonconsolidated basis, indicates that the risk on a consolidated basis is fully reserved.

Note: The risk-monitored loan classification is a disclosure standard based on regulations used to enforce the Banking Law.

Factors in the Increase in "Risk-monitored Loans" (Comparison with March 31, 1998)

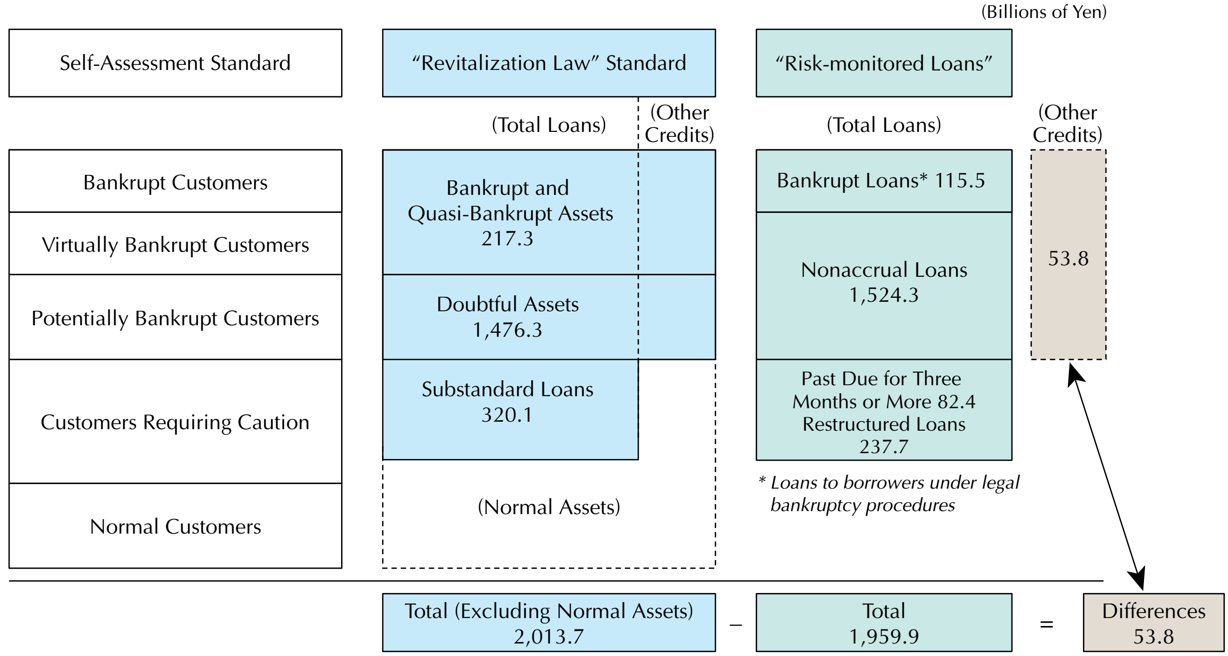
(Billions of Yen)

	Nonaccrual Loans		Past-due Loans**	Restructured Loans	Total
	Bankrupt Loans*	Nonaccrual Loans			
March 31, 1998	257.9	544.8	311.3	355.2	1,469.2
Net Changes	(142.4)	727.2	(125.5)	31.4	490.7
Actual Changes	30.4	(109.9)	(125.5)	31.4	(173.6)
Direct Reduction	(172.8)	(169.1)	—	—	(341.9)
Effect of the Change***	—	1,006.2	—	—	1,006.2
Changes among the Categories	—	252.3	(103.4)	(148.9)	—
March 31, 1999	115.5	1,524.3	82.4	237.7	1,959.9

**Loans to borrowers under legal bankruptcy procedures* ***Past due for three months or more*
****Effect of the change on the definition of "Nonaccrual"*

Differences between "Risk-monitored Loans" and the "Revitalization Law" Standard

(Billions of Yen)



Note: The amount of direct reduction is:
The "Revitalization Law" standard = ¥385.6 billion;
"Risk-monitored Loans" = ¥341.9 billion.

Problem Assets by Domicile of Borrower

(Billions of Yen, %)

	"Revitalization Law" Standard (Percentage of the Total)		"Risk-monitored Loans" (Percentage of the Total)	
Domestic	1,886.0	(93.7%)	1,842.5	(94.0%)
Overseas	127.7	(6.3%)	117.4	(6.0%)
Asia	97.6	(4.8%)	91.4	(4.7%)
Indonesia	46.6	(2.3%)	44.7	(2.3%)
China	20.5	(1.0%)	19.4	(1.0%)
Thailand	13.8	(0.7%)	13.8	(0.7%)
Hong Kong	11.8	(0.6%)	9.2	(0.5%)
Others	4.9	(0.2%)	4.3	(0.2%)
North America	25.8	(1.3%)	23.1	(1.2%)
Western Europe	2.2	(0.1%)	2.1	(0.1%)
Eastern Europe	2.1	(0.1%)	0.8	(0.0%)
Total	2,013.7	(100.0%)	1,959.9	(100.0%)

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

Problem Assets by Domicile and Type of Borrower

(Billions of Yen, %)

	"Revitalization Law" Standard (Percentage of the Total)		"Risk-monitored Loans" (Percentage of the Total)	
Domestic	1,886.0	(100.0%)	1,842.5	(100.0%)
Manufacturing	67.3	(3.6%)	67.0	(3.6%)
Agriculture, Forestry and Fishery	44.7	(2.4%)	39.3	(2.1%)
Construction	57.7	(3.1%)	57.6	(3.1%)
Wholesale and Retail Trade	133.8	(7.1%)	127.5	(6.9%)
Financial Institutions	114.9	(6.1%)	105.4	(5.7%)
Real Estate	737.4	(39.1%)	728.0	(39.5%)
Transportation, Communication and Other Public Enterprises	8.2	(0.4%)	8.1	(0.4%)
Services	685.0	(36.3%)	673.4	(36.5%)
Municipalities	—	(—)	—	(—)
Other	37.0	(2.0%)	36.2	(2.0%)
Overseas	127.7		117.4	
Public Sector	—		—	
Financial Institutions	5.7		5.6	
Commerce and Industry	122.0		111.8	
Other	—		—	
Total	2,013.7		1,959.9	

Comparison between Consolidated and Nonconsolidated Basis

(1) "Risk-monitored Loans"

(Billions of Yen, %)

	Consolidated (Percentage of Total Loans)			Nonconsolidated (Percentage of Total Loans)		
Bankrupt Loans		208.3	(0.6%)		115.5	(0.3%)
Nonaccrual Loans		1,678.4	(4.7%)		1,524.3	(4.5%)
Past Due for Three Months or More		170.9	(0.5%)		82.4	(0.2%)
Restructured Loans		283.0	(0.8%)		237.7	(0.7%)
Total Risk-monitored Loans (a)	(Note 1)	2,340.6	(6.6%)	(Note 2)	1,959.9	(5.8%)

Notes: 1. After direct reduction of ¥453.5 billion
2. After direct reduction of ¥3,41.9 billion

(2) Reserve for Possible Loan Losses

(Billions of Yen)

	Consolidated	Nonconsolidated
General Reserve	348.1	318.7
Specific Reserve	904.3	718.8
Loan Loss Reserve for Specific Overseas Countries	15.6	15.5
Reserve for Possible Loan Losses (b)	1,267.9	1,053.0
Reserve Ratio (b)/(a)	54.2%	53.7%

(3) Credit Cost (Including General Reserve)

(Billions of Yen)

	Consolidated	Nonconsolidated
Net Provision for General Reserve (Note)	(174.8)	(176.3)
Net Provision for Specific Reserve	(461.2)	(371.8)
Write-off of Loans	(369.7)	(305.0)
Others	(259.6)	(219.3)
Reserve for Possible Loan Losses	(1,265.3)	(1,072. 4)

Note: Net provision for general reserve is accounted for in the core banking profit.