DEALING WITH PROBLEM LOANS

STANDARDS FOR WRITE-OFFS AND RESERVES

DKB resolved to adopt the standards for the assessment of loan assets as official corporate rules, which are in line with the guidelines set by the Ministry of Finance under Japan's newly introduced Prompt Corrective Action system. Business branches and credit divisions that belong to the business operating line perform the self-assessments required under this system, and the independent internal audit line reviews the contents.

The standards for write-offs and reserves are in line with the guidelines published by the Japan Association of Certified Public Accountants and are approved by the Board of Directors and the Management Committee.

AMOUNTS OF WRITE-OFFS AND RESERVES

Total losses from bad debt rose to ¥752.8 billion for the fiscal year under review, which was ¥132.6 billion higher than for the previous fiscal year, the principal factor leading to the net loss in fiscal 1997.

LOANS TO THE CONSTRUCTION, NONBANKING, AND REAL ESTATE INDUSTRIES

In view of conditions in the construction, nonbanking, and real estate industries, we made additional provisions based on default rates to these sectors.

These actions go beyond regulatory requirements and are based on DKB's policy to maintain sound practices in dealing with problem loans.

LOANS TO BORROWERS IN ASIA

With regard to the heightened country risks in Asian countries followed by the region's economic crisis, DKB recently completed a review of its credit assessment guidelines for borrowers in Asia and made write-offs and reserves. As a consequence, reserves for loans to Asian borrowers amounted to approximately ¥45.0 billion, and most of these were included in the reserve for special purposes (refer to page 25 for information on loans outstanding to borrowers in Asia).

Balance of Problem Loans

Under previous standards, DKB had total problem loans of ¥1,185.4 billion, ¥249.2 billion lower than at the previous year-end. This includes ¥1,007.9 billion in nonperforming loans, a ¥143.7 billion decline from the previous year, due mainly to write-offs, sales of real estate collateral pledged against these loans, and sales of collateralized loans.

Until recently, Japanese banks were generally required to obtain a certification of the regulatory authority when making provisions and write-offs. Following the elimination of such regulations, and with the introduction of new standards for credit assessment, DKB made ¥326.7 billion in write-offs, including some loans provisioned in the previous years.

As of March 31, 1998, the problem loans under the previous standards remaining on DKB's balance sheet in various categories were as follows:

- ¥394.3 billion in loans to borrowers under bankruptcy proceedings,
- ¥613.6 billion in loans with interest payments more than six months in arrears,
- ¥113.8 billion in restructured loans, and
- ¥63.6 billion in loans to borrowers under financial support programs.

Introduction of Risk-Managed Loans

In the interest of encouraging disclosure according to international standards, the Federation of Bankers' Associations of Japan has introduced new standards of risk-managed loans that indicate the soundness of a bank's assets. Under the previous standards, loans to borrowers under bankruptcy proceedings, loans with interest payments more than six months in arrears, restructured loans, and loans to borrowers under financial support were disclosed. Under the new standards, loans past due for three months or more and loans with altered lending conditions have been added to previous categories. Loans with altered lending conditions include previously disclosed restructured loans and loans to borrowers under financial support. From fiscal 1998, we will use the new standard exclusively.

Risk-managed loans as of March 31, 1998, are as follows:

Loans to borrowers under bankruptcy proceedings and loans with interest payments more than six months in arrears remained the same as with the previous standard. Loans past due for three months or more were ¥158.6 billion. Loans with altered lending conditions, which include previously disclosed restructured loans and loans to borrowers under financial support programs, amounted to ¥304.7 billion. Thus, under the new standard, risk-managed loans in all categories amounted to ¥1,471.3 billion.

Compliance System

After questionable loan transactions came to light in fiscal 1997, we established our own independent compliance system to demonstrate our strong determination to eliminate any and all transactions that are suspected of being illegal or should be ceased due to our responsibility to the public and society.

The Internal Audit & Compliance Committee was established in July 1997 to make decisions on important issues concerning internal audits, including the establishment of guidelines for audits of the Bank's operations. The Internal Audit & Compliance Coordination Office serves as the committee's secretariat. To guarantee that the supervisory authorities work in close coordination, the Inspection and Legal divisions and the Credit Audit Office have been placed under this committee. Also, independent consultants, drawn from the legal and accounting professions, were appointed to review the effectiveness of the committee's activities with the aim of ensuring compliance by banking divisions and employees and the proper conduct of the Bank's internal supervisory process.

Compliance Managers and Compliance Supervisors are appointed at each of the branches and divisions. The General Manager assumes the role of Compliance Manager and is responsible for all matters pertaining to compliance at his or her division or branch. One of the Deputy General Managers assumes the role of Compliance Supervisor and manages all matters with respect to compliance in accordance with the directions given by the Compliance Manager.

Also, the Compliance Consultant Office has been established, thereby allowing employees to discuss compliance-related matters.

We firmly believe this compliance system has sent a strong message internally and externally regarding our policy of maintaining sound and transparent operations on a permanent basis.