UFJ Announces Aggressive Measures to Reinforce Internal Control Framework

UFJ Holdings and UFJ Bank received administrative actions from the Japanese Financial Services Agency (FSA) today. UFJ takes this extremely seriously and will undertake a series of measures to reinforce its internal control systems in order to prevent these problems recurring in the future. UFJ regrets and sincerely apologizes for the concern amongst its customers, shareholders and other related parties that this has caused. The measures announced today are also aimed at restoring confidence in UFJ as quickly as possible.

Summary

UFJ understands that imperfections in the internal control systems of UFJ Holdings and UFJ Bank led to the FSA taking the administrative actions. The UFJ Group makes a strong commitment to part from the past and reinforce its internal control framework under the leadership of the new management team, which was announced on May 24th.

1. Details of the administrative actions
   The administrative actions we received today are as follows:

A. UFJ response to the FSA's inspections

(1) Details of the administrative action
   - We received the administrative action due to the following reasons:
In the course of the FSA's inspections, there were deeds, which were considered to be evasions from inspection, and inappropriate responses to the inspections, including “movement and concealment of documents and data that could have substantially affected the classifications etc., had been systematically conducted”, “false responses regarding the existence of separate rooms to stock documents”, “destroying some of the documents in the presence of inspectors”, “submission of altered documents, such as minutes of meetings related to credit assessment and documents concerning a specific borrower requested by inspectors, was systematically conducted”, “false explanations regarding some borrowers based on concealment of documents and data”.

As a result of these deeds and responses to the inspections, it became difficult to correctly judge the classifications of borrowers and the needed level of write-offs and provisions. Moreover, efficient implementation of the inspections was hampered and, as a result, the inspection period was considerably prolonged.

- The details of the administrative action are as follows:
  - The bank must strengthen its operations and internal controls to properly receive the FSA's inspections.
  - The bank must strengthen internal controls in order to enhance compliance functions and to ensure the proper management of operations.
  - The bank must submit a business improvement plan to the FSA.
  - The bank must report the progress in the implementation of the plan to the FSA on a quarterly basis.

(2) UFJ’s understanding
- We sincerely regret that, in the course of the inspections, there were some dissatisfactory and careless actions, which could have been construed as violations of laws and ordinances, although the actions were not so intended.
- We recognize that inadequacies in our internal control framework caused these actions.

(3) Measures to prevent recurrence
UFJ Bank will take the following measures to prevent recurrence, in addition to aggressively improving its compliance framework:
- The bank will take measures such as restructuring its internal control systems, reviewing its procedures to monitor large troubled borrowers, and others.
Specifically, the bank will invite external specialists to establish a “Credit Risk Management Committee”, in order to secure objective views of third parties. In addition, aiming to strengthen mutual checking in credit risk management, the bank will strengthen checking functions among the related divisions by establishing a team, which will specialize in large borrowers, within the Internal Audit Department.

- The bank will review its rules on self-assessment, provisions and write-offs, and disclosure of problem loans under the Financial Reconstruction Law etc., and will thoroughly apply these rules, and will heighten employees’ awareness of compliance.

B. Failure to meet the profit target stated in plan to revitalize management

(1) Details of the administrative action

In addition to the business improvement order based on the financial results for fiscal 2002, UFJ received another business improvement order, since profit for fiscal 2003 largely undershot the target stated in the plan to revitalize management.

The details of the order were as follows:

- UFJ Holdings must revise its ongoing business improvement plan and submit a new business improvement plan to the FSA, which contains measures to establish responsible management and to fundamentally improve profitability.
- UFJ Holdings must steadily implement the new business improvement plan.
- UFJ Holdings must report the progress in the implementation of the plan on a quarterly basis, until it is confirmed that the plan is fully implemented.

(2) UFJ’s understanding

- We deeply regret that we posted a net loss as amounting to ¥372.3 billion (on a combined basis for UFJ’s subsidiary banks) so as to receive business improvement orders for two consecutive years.
- In spite of reporting a business profit before net transfer to general reserve, which shows the profitability of our core businesses, which overshot the plan to revitalize management, net income largely undershot the target, because credit related expenses exceeded the plan. This was because the bank increased provisions primarily for large borrowers, considering the uncertainty to incur unexpected additional losses in reducing its problem loan ratio by half, by the end of fiscal 2004.
(3) Measures to prevent recurrence

- The new management team will prepare a business improvement plan in accordance with the FSA’s guidelines. This plan will include aggressive measures to increase profitability, such as the development of marketing systems to expand our customer base. UFJ’s new management team is committed to making every effort to achieve the new measures, which will be laid out in the business improvement plan.

- UFJ has already implemented large reduction in the compensation for directors and executive officers, and are considering a 20% reduction in bonuses for employees for the first half of this fiscal year.

C. Stance on loans to small- & medium-sized enterprises (SMEs)

(1) Details of the administrative action

UFJ’s procedure to monitor and verify SME lending was deemed to be inadequate by the FSA. UFJ received a business improvement order, since the FSA deemed this to be “a case where a bank is deemed not to properly comply with the plan to revitalize management”, which was stated in the “administrative treatment related to follow up of the capital injected banks”.

The details of the administrative order were as follows:

- UFJ Holdings and UFJ Bank must submit business improvement plans to the FSA, which contain concrete measures to improve the management of loans to SMEs.
- UFJ Holdings and UFJ Bank must steadily implement the business improvement plans.
- UFJ Holdings and UFJ Bank must report the progress in the implementation of the plans on a quarterly basis, until their completion.

(2) UFJ’s understanding

- We deeply regret that, at UFJ Bank, the procedure to manage SME lending, an important item in the plan to revitalize management, has not adequately functioned.

- Specifically, the rules for registering customer information such as industries, capital and number of employees for segmenting purposes, and extraction of individual loans for businesses, were not appropriate, and that examination of accuracy in segmentation and registration was inadequate. As a result, the bank
counted some loans to large corporations as lending to SMEs, and missed some SME lending.
- In addition, since there were inadequacies in the measures taken by the headquarters and the instructions given to branches, the bank reported a certain amount of short-term lending at the fiscal year end, which did not necessarily fit this purpose.
- UFJ Holdings, which has a direct obligation to report to the FSA, has reported figures without adequate examination.
- We sincerely apologize that our database management has not appropriately functioned and that, as a result, we have submitted inaccurate reports.

(3) Measures to prevent recurrence
- UFJ will make and submit a business improvement plan, which includes reform of the database management, based on appropriate customer segmentation. In addition we will promote reform in our lending business, and will review our marketing platform, in accordance with the objectives of Law No.5 relating to Emergency Measures for Early Reconstruction of Financial Systems. By these measures, we will further provide sufficient funds in response to the financing needs of healthy SMEs.
- In addition, we are currently examining past results.

D. Internal control framework related to credit risk management

(1) Details of the administrative action
We received an administrative action because the FSA found a critical imperfection in our internal control framework, including inadequacy regarding appropriate procedures to manage credit risk and intersectional monitoring functions. The imperfection was demonstrated by the fact that provisions were increased by ¥500 billion, when we announced our financial results. This increase was deemed necessary, as we did not make a management decision to revise earnings forecasts for fiscal 2003, based on an adequate review of provisions.

The details of the administrative action were as follows:

- With a view to further enhancing credit risk management through timely and correct understanding and control of future risk factors, UFJ Holdings and UFJ Bank must strengthen internal controls.
- UFJ Holdings and UFJ Bank must submit business improvement plans to
the FSA, and steadily implement these plans.

- UFJ Holdings and UFJ Bank must report progress in the implementation of the plans on a quarterly basis, until their completion.

(2) UFJ's understanding

- UFJ Holdings revised its fiscal 2003 earnings forecasts on April 28th followed by the announcement of the financial results on May 24th. The earnings announcement on May 24th was substantially different from the revised forecasts announced in April.

- The difference between the two announcements resulted from the approximately ¥500 billion increase in the amount of reserves for loan losses at UFJ Bank. This increase reflected our sufficiently considered and conservative forecasts that our actions toward reducing the amount of problem loans would increase uncertainty related to unexpected credit related expenses.

- However, if we had made such a decision on April 28th, we would not have given concern to our customers, shareholders and other related parties by the second revision.

(3) Measures to prevent recurrence

- UFJ Holdings and UFJ Bank will clarify their stance in credit risk management, reinforce the functions of the Board of Directors’ Meetings and improve internal control framework, including strengthening intersectional monitoring functions through the following measures, aiming to be able to make sufficiently considered and conservative management decisions concerning credit risk:

  - The bank will invite external specialists to establish a “Credit Risk Management Committee” in order to secure objectivity.
  - The revision of rules and other important issues will be discussed at the Credit Risk Management Committee.
  - The function of the Board of Directors will be reinforced in order to strengthen intersectional monitoring, by reflecting the opinions of the Credit Risk Management Committee into its decision-making process.

2. Future Direction of Management

The management teams of UFJ Holdings and UFJ Bank take the business improvement orders very seriously. UFJ will place improvement in corporate governance, primarily of the internal control framework such as credit risk management, as a top priority.
In addition to implementing the measures stated above to prevent these problems from recurring, UFJ will make efforts to improve transparency in management, including referring to objective opinions of third parties. For this purpose, UFJ will consider to become a corporation with an executive committee corporate governance structure, as defined by the Japanese Commercial Code.

We are determined to implement thorough management reforms, in order to part from the past. Our strong determination is demonstrated by the complete renewal of our management teams as well as the decision to reduce compensation for directors and executive officers and bonuses for employees.

3. Clarification of responsibilities

In response to the series of administrative actions, we will clarify responsibilities.

(1) The previous top management, namely, the Presidents of UFJ Holdings, UFJ Bank and UFJ Trust Bank, have already resigned or been scheduled to resign, based on the fact that we posted a net loss and suspend dividend payment to common shareholders for fiscal 2003.

(2) Compensation for all directors and executive officers will be cut by half for the time being. (Compensation for corporate auditors will be discussed at the Board of Corporate Auditors.)

(3) In addition, in terms of the senior management, who were in charge of the areas where we received the administrative orders, six have already resigned or been scheduled to resign, and a penalty (additional reduction in compensation by 5-15%) will be applied to five of these executives.

(4) Furthermore, UFJ plans to further clarify responsibilities of employees at senior positions, who are responsible for the areas concerned by the administrative orders.