AOZORA BANK, LTD.

2003

AOZORA BANK, LTD.
Annual Report
Year Ended March 31, 2003

AOZORA

PROFILE

In January 2001, we changed our name to Aozora Bank, Ltd., and set out to become a bank that fulfills a distinctive role within Japan's rapidly evolving economy and society. By always being close by, we are able to respond in a timely and expert manner to meet a diverse range of customer needs.

In April 2003, we announced the Trinity Plan management strategy. Based on a review of our performance since returning to private ownership and our key competitive strengths, the plan highlights three strategic areas on which we will focus our operations: (1) finance for medium-sized enterprises; (2) revitalization business; and (3) originating, structuring and distributing financial products. By forming organic linkages among these operations, we aim to generate significant synergies. As we continue to provide value-added financial services and strive to enhance our profitability and the quality of our asset base, we intend to achieve a relisting of the Bank's shares in the fiscal year ending March 31, 2006.

Established . . . . April 1957

Capital stock . . . . ¥419.8 billion

Total assets . . . . ¥5,895.3 billion

Consolidated capital adequacy ratio (domestic standard) 13.30%

Number of employees 1,370

Branch network . . . . Japan: 17 branches
Overseas: 3 representative offices

Head office . . . . 3-1, Kudan-minami 1-chome,
Chiyoda-ku, Tokyo 102-8660, Japan

Long-Term Credit Ratings

JCR:		A–
R&I:		BBB
Moody's:	Long-term deposits	Baa2
	Long-term debt	Baa3
Fitch Ratings:		BBB–

(As of March 31, 2003)

Note: In this report, yen amounts stated in millions of yen have been truncated. Amounts expressed in billions of yen have been rounded to the nearest ¥0.1 billion.

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FINANCIAL HIGHLIGHTS

In the fiscal year ended March 31, 2003, the Bank recorded consolidated net income of ¥23.4 billion, a ¥4.7 billion increase compared with the previous period. Along with steady net interest income, net fees and commissions and net trading revenues posted significant increases. An improvement in the quality of the Bank's assets led to a large decrease in credit-related expenses, which contributed to the 25.0% rise in net income. As of March 31, 2003, the Bank's consolidated capital adequacy ratio (domestic standard) stood at 13.30%, maintaining its previously high level.

Consolidated

(Millions of Yen)

	2003	2002	2001
Operating income (Note 1)	109,748	106,700	275,730
Ordinary profit (Note 1)	8,920	14,355	99,116
Net income (Note 1)	23,376	18,703	98,331
Capital stock	419,781	419,781	419,781
Total stockholders' equity	497,514	477,046	460,876
Total assets	5,885,642	5,684,072	6,163,766
Debentures	1,470,126	1,468,193	2,479,408
Deposits (Note 2)	2,537,175	2,164,641	1,771,373
Loans and bills discounted	3,258,693	3,297,993	3,089,490
Securities	1,350,036	1,054,019	721,477
Basic net income per share (yen) (Note 1)	7.02	5.37	35.80
Total stockholders' equity per share (yen)	75.29	68.07	62.36
Consolidated capital adequacy ratio (domestic standard)	13.30%	14.05%	15.13%
Tier I ratio (domestic standard)	12.51%	12.88%	13.36%
Return on equity (ROE) (Note 3)	9.79%	8.24%	42.55%

Non-Consolidated

(Millions of Yen)

	2003	2002	2001
Operating income (Note 1)	101,633	100,984	270,720
Business profit before general loan-loss reserve	33,479	25,925	16,795
Ordinary profit (Note 1)	7,437	13,706	98,971
Net income (Note 1)	22,875	18,563	99,690
Capital stock	419,781	419,781	419,781
Total stockholders' equity	496,918	476,166	459,690
Total assets	5,895,314	5,687,366	6,174,922
Debentures	1,473,126	1,470,193	2,472,528
Deposits (Note 2)	2,555,905	2,177,240	1,778,939
Loans and bills discounted	3,271,087	3,304,379	3,092,049
Securities	1,356,754	1,060,690	727,758
Net income per share (yen) (Note 1)	6.84	5.32	36.31
Total stockholders' equity per share (yen)	75.08	67.76	61.94
Capital adequacy ratio (domestic standard)	13.26%	14.00%	15.10%
Tier I ratio (domestic standard)	12.47%	12.83%	13.32%
Return on equity (ROE) (Note 3)	9.58%	8.21%	43.37%

Notes: 1. In the fiscal year ended March 31, 2001, operating income, ordinary profit and net income included a one-off ¥85.0 billion gain on sales of equity securities, carried out as a measure to strengthen the Bank's capital base when it returned to private ownership.

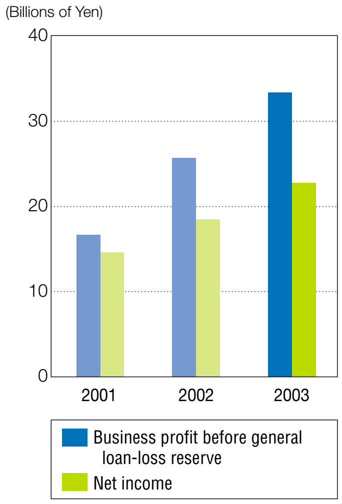
2. Includes negotiable certificates of deposit (NCDs)

3. ROE =

$$\frac{\text{(Net income – Dividends paid on preferred stock)}}{\left\{\left(\begin{array}{c}\text{Total stockholders' equity}\\ \text{at beginning of term}\end{array} - \begin{array}{c}\text{Number of preferred shares}\\ \text{outstanding at beginning of term}\end{array} \times \begin{array}{c}\text{Issue}\\ \text{price}\end{array}\right) + \left(\begin{array}{c}\text{Total stockholders' equity}\\ \text{at end of term}\end{array} - \begin{array}{c}\text{Number of preferred shares}\\ \text{outstanding at end of term}\end{array} \times \begin{array}{c}\text{Issue}\\ \text{price}\end{array}\right)\right\} \div 2} \times 100$$

For the fiscal year ended March 31, 2001, no adjustments were made relating to preferred shares as total stockholders' equity at beginning of term was nil (¥0).

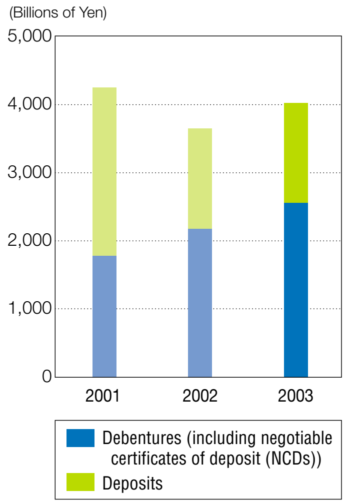
Business Profit before General Loan-Loss Reserve and Net Income
(Non-Consolidated)



● Business profit before general loan-loss reserve grew 29.1%, reflecting increases in non-interest income, including fees and commissions and trading revenues. Net income rose 23.2%, partly owing to a decrease in credit-related expenses.

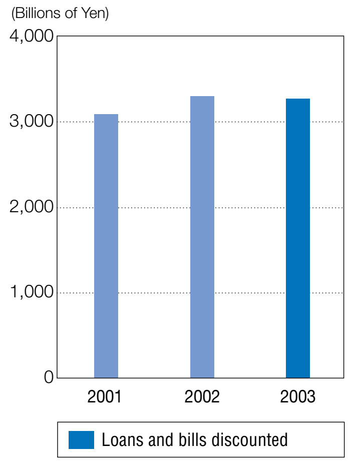
Note: Net income for the fiscal year ended March 31, 2001, excludes a one-off ¥85.0 billion gain on sales of equity securities, carried out when the Bank returned to private ownership.

Debentures and Deposits
(Non-Consolidated)



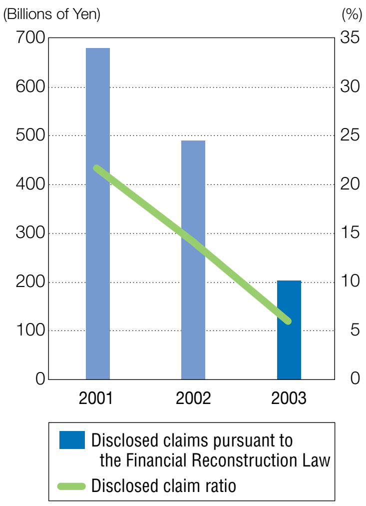
● Debentures were relatively steady. Deposits (including NCDs) increased ¥378.7 billion, or 17.4%, compared with the previous period. This increase included an approximately 50% increase in deposits by individual customers.

Loans and Bills Discounted
(Non-Consolidated)



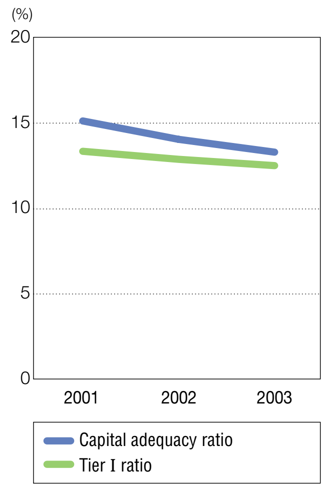
● Loans and bills discounted declined 1.0%. This reflected our accumulation of high-quality assets through strengthened sales activities targeting sound borrowers, in addition to progress in disposing of non-performing loans.

Disclosed Claims Pursuant to the Financial Reconstruction Law
(Non-Consolidated)



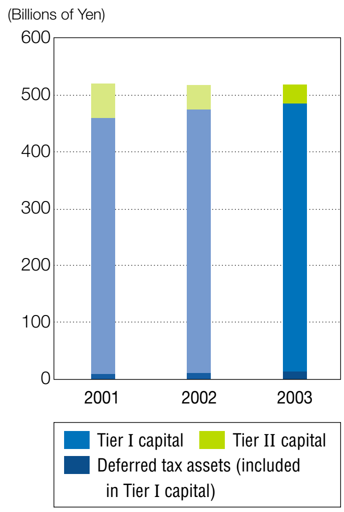
● As a result of steady and effective disposal of problem loans, disclosed claims under the Financial Reconstruction Law declined 58.6%, to ¥202.5 billion. Consequently, the disclosed claims ratio fell 8.22 percentage points, to 5.97%.

Capital Adequacy Ratio (Domestic Standard) and Tier I Ratio
(Consolidated)



● In addition to an increase in risk-weighted assets, reflecting the accumulation of high-quality assets, Tier II capital qualifying as capital declined. This was mainly attributable to a reduction in subordinated debt. As a result, the capital adequacy ratio stood at 13.30%.

Breakdown of Capital Adequacy
(Consolidated)



● Most of the Bank's capital is Tier I capital, allowing the Bank to maintain a high-quality capital base. Deferred tax assets of ¥13.8 billion account for 2.8% of Tier I capital.

Despite the continued lackluster performance of the domestic economy, Aozora Bank achieved steady results in the fiscal year ended March 31, 2003. Since the launch of the new bank in September 2000, we have met the targets specified in the Business Revitalization Plan in all three fiscal periods. These accomplishments were only possible thanks to the invaluable support and understanding received from our customers, shareholders and the general public, for which we, the officers and employees of the Bank, wish to express our sincerest gratitude. In April 2003, the Bank announced its new management strategy, named the Trinity Plan, within which we reaffirm our goal of having the Bank relisted on the Tokyo Stock Exchange in the fiscal year ending March 31, 2006. We will continue with our efforts to solve management issues, strengthen profitability and be a bank that provides high-quality services.

Performance in the Fiscal Year Ended March 31, 2003

In the fiscal year ended March 31, 2003, the Bank surpassed all the major targets adopted in the Business Revitalization Plan. The Bank posted gross business profit of ¥72.2 billion, business profit before general loan-loss reserve of ¥33.5 billion and net income of ¥22.9 billion (all figures on a non-consolidated basis). As of March 31, 2003, the consolidated capital adequacy ratio (domestic standard) was 13.30% and the Tier I ratio (domestic standard) was 12.51%.

One of the most important issues we are dealing with is that of problem loans. During the period under review, we reduced disclosed claims under the Financial Reconstruction Law by more than half, to ¥202.5 billion, or 5.97% of total credit held by the Bank. Based on strict internal self-assessment standards, the Bank also maintains a high level of coverage (reserves, collateral, guarantees, etc.) for disclosed claims.

In our lending operations, we responded to healthy corporate funding requirements by cultivating new customers and providing tailor-made financing solutions, particularly focusing on medium-sized firms. Through the accumulation of high-quality assets, our balance of normal credit rose ¥225.7 billion compared with the end of the previous period, while steady efforts to dispose of non-performing assets saw our balance of loans outstanding decrease ¥33.3 billion, to ¥3,271.1 billion, at the end of the fiscal year ended March 31, 2003.

The Bank posted non-interest income substantially higher than in the previous period. Net fees and commissions, such as those earned through loan syndications and commitment lines of credit, and net trading revenues recorded robust performances, raising their combined share of gross business profit approximately 10 percentage points, to 17.6%. This result shows that the Bank is steadily increasing its earnings capabilities outside traditional lending-based operations. Our non-recourse finance operations also achieved strong growth, increasing our presence in the market. These operations included distressed debt and corporate recovery-related business as well as real estate securitization and securitization of receivables.

In our retail banking operations, the growth in popularity of telephone banking helped such deposit products as the Aozora Direct Time Deposit, which continued its strong performance. Our branch network bolstered its lineup of products and services, including the commencement of sales of investment trusts and life

Aozora Bank aims to be a customer-driven financial institution, providing value-added financial services that support businesses in realizing their full growth potential.

insurance policies and the expansion of consultation services. In April 2002, Aozora Card Co., Ltd., began operations and achieved solid results in its first year.

Other new areas included the public issuance of collateralized loan obligations (CLOs), as we aim to diversify the fund-raising methods available to us.

Formulation of a New Management Strategy: The Trinity Plan

In April 2003, we announced the Bank's new management strategy, named the Trinity Plan. Two key goals of the plan are (1) relisting the Bank's shares and (2) acquiring a credit rating that will put us in the top echelon of Japanese banks. In the two-and-a-half years since the Bank's return to private ownership in September 2000, we have applied ourselves in earnest to rebuilding the trust of our customers and meeting the targets set out in the Business Revitalization Plan. Considerable progress has been made. Following a process in which we examined past operating performance and identified the Bank's key competitive strengths, we formulated the Trinity Plan with the aim of bolstering the Bank's earnings potential and shaping a bank with originality. The plan spells out the strategic areas on which the Bank will focus and how it will develop those operations. The Trinity Plan was formulated to further strengthen the Bank's earnings potential and originality, reflecting the Bank's achievements over the past two-and-a-half years. The plan specifies three strategic focus areas: (1) finance for medium-sized enterprises; (2) revitalization business; and (3) originating, structuring and distributing financial products, as well as how we will develop our business operations. The Bank will seek to develop these areas in an integrated way, thereby creating synergies between them.

Measures to Rebuild the Organizational Infrastructure for the Trinity Plan

The Bank is taking the following steps to improve its organizational infrastructure.

1. Introduction of a credit rating system and application of spread guidelines
   The Bank has succeeded in streamlining the administration process required on lending operations by introducing an in-house credit rating system and spread guideline rules. Under the credit rating system, security coverage (coverage provided by collateral and guarantees) and recovery cash flow projections are taken into account when considering the pricing of each loan. Each transaction is automatically classified into one of approximately 800 different rating categories with different spread requirements. Moving forward, we will enhance operational efficiency and speed up the credit screening process.
2. Delegation of authority and responsibility to front-line management
   The Bank has introduced an internal system whereby Group executives are appointed as heads responsible for human resources, decision making and performance within their assigned divisions. This will enable us to promote efficiency and determine responsibility for business operations.
3. Structural reorganization and reallocation of human resources
   The Bank has streamlined its back-office functions, reorganized its divisional structure, enhanced its recruitment of specialists and reallocated its human resources. Specifically, we have (1) doubled the number of divisions focusing on developing relationships with new clients, (2) increased human resources in the Special Finance Division and (3) built a structure that enables business divisions to collaborate more closely with financial engineering related divisions and promote business contacts.
4. A new human resources management system
   In July 2003, the Bank fully implemented a new human resources management system. This system, which was initially introduced on a trial basis in April 2002, will provide a more open and fair assessment process and further encourage employees to take on challenging tasks. We are confident that the system will provide the optimum set of incentives to get the best performance out of our staff.

Management Issues

The Bank made significant progress in improving the quality of its asset portfolio in the fiscal year ended March 31, 2003, through the disposal of problem loans. At March 31, 2003, the Bank had succeeded in lowering problem credit outstanding as a percentage of total credit to less than 6%, down from 24% at September 30, 2000. The Bank is committed to lowering this percentage even further.

At the same time, the Bank is taking steps to ensure good corporate governance in terms of transparency and soundness of management. Internal controls have also been strengthened in terms of compliance and risk management.

In addition, the Bank is currently restructuring its computer systems by outsourcing its main operation systems, enabling it to reduce operational costs and rationalize workflows.

Shareholders

The Bank ended its period under special public management and started anew in September 2000 when a consortium led by SOFTBANK CORP., ORIX Corporation and The Tokio Marine and Fire Insurance Co., Ltd. acquired shares in the Bank from the Deposit Insurance Corporation with the approval of Financial Reconstruction Commission. Since then, the Bank has striven to rebuild confidence and regain the trust of its clients to become a bank with: (1) high earnings potential and a sound portfolio; (2) originality; and (3) a distinctive role in the rejuvenation of the Japanese economy. Recently, SOFTBANK, the Bank's largest shareholder, decided to transfer its shareholding to U.S.-based Cerberus Group. Cerberus Group, which will become the Bank's principal shareholder, has been a major shareholder of the Bank since September 2000 and is one of the world's largest corporate recovery funds. Cerberus Group has already shown its commitment to support the Bank's current management policies in cooperation with the other existing shareholders. We will continue to be a bank that contributes to society based on the philosophies we have adopted since our return to private ownership.

In Closing

In March 2003, we moved to our new headquarters. This has given all of the Bank's directors and employees the opportunity to start the new fiscal year with a fresh outlook, highly focused on relisting the Bank's shares.

We look forward to your continued support and understanding.

August 2003

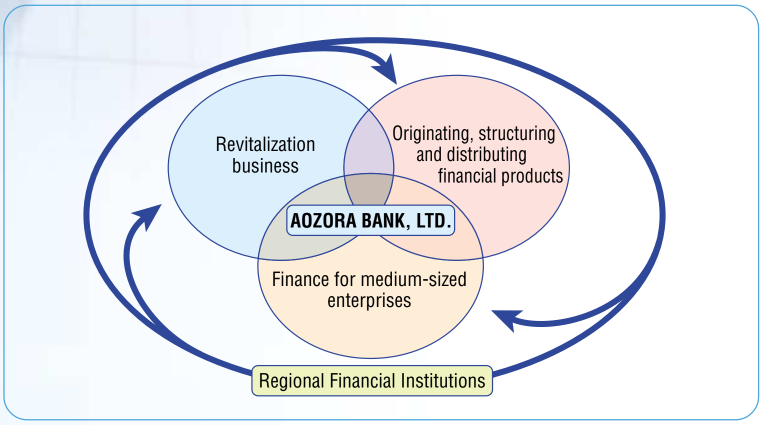
Hiroshi Maruyama
President and CEO

Outline of the Bank's Management Strategy

Aozora Bank has formulated a management strategy, named the Trinity Plan, which calls for the Bank to achieve a credit rating that will put it in the top echelon of Japanese banks and a relisting of its shares on the Tokyo Stock Exchange in the fiscal period ending March 31, 2006.

In formulating the Trinity Plan, we set out to identify the Bank's key competitive strengths based on its performance in a variety of fields over the two-and-a-half years since the new bank was launched in September 2000. From this process, we chose three strategic areas on which the Bank will focus: (1) finance for medium-sized enterprises; (2) revitalization business; and (3) originating, structuring and distributing financial products. The strategic areas under the Trinity Plan are given priority in terms of management resources, as we contribute to the rejuvenation of the Japanese economy and bolster the Bank's earnings potential.

These three strategic areas of operation will not be developed as stand-alone businesses, but rather will be closely connected to take advantage of the Bank's distinctive strengths. From this will emerge a trinity of operations, thereby generating significant synergies for both the Bank and its customers.



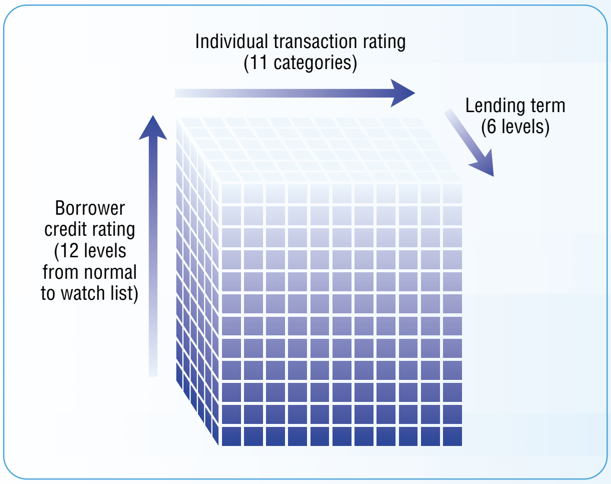
Finance for Medium-Sized Enterprises

We provide support for and enhance the corporate value of our medium-sized enterprise customers, which are the mainstay of the Japanese economy and "the companies that will lead the next generation in Japan," by providing loans and other types of financial services.

Aozora Bank has traditionally provided stable funding to small and medium-sized enterprise customers. Since the launch of the new bank, the number of new corporate customers has grown to account for over half of the Bank's lending clientele. Lending to medium-sized enterprises, which is one of the Bank's key strengths, is the core of our strategy and highlighted as being particularly crucial to the revitalization of the Japanese economy.

We focus on medium-sized enterprise finance, applying the internal credit rating system to every transaction with domestic corporate clients. This system, which has proven its effectiveness since being fully adopted in October 2001, takes into account coverage provided by collateral and guarantees as well as probability of recovery based on cash flows, use of funds and repayment resources. The system classifies transactions by considering probability of recovery, borrower credit rating and lending term, giving approximately 800 possible ratings. As a result, for all transactions we accurately estimate the credit cost and determine the appropriate interest rate. By introducing a precise model for transaction credit rating, we have standardized risk-return decisions and sped up the credit screening process. The system allows us to judge risk and provide services to customers who do not have collateral.

To effectively implement our strategy, we have doubled the number of divisions targeting new corporate finance clients, allocated more sales staff to the Tokyo metropolitan area and relocated the decision-making function to the "front-line," where the system of credit rating mentioned previously has already become firmly established. These measures enable us to provide an even more rapid response to our customers' needs.



Revitalization Business

The Bank supports the revitalization of existing businesses as well as the expansion of new businesses, on either a whole company or business unit level, thereby helping to nurture "the companies that will lead the next generation in Japan." The Bank is committed to helping its corporate clients enhance their corporate value by providing assistance to revitalize unprofitable businesses. As well as corporate revitalization, these services encompass such areas as the recovery of stagnant businesses and dormant assets from within companies as well as the start-up of new businesses.

The Bank provides tailor-made services, taking advantage of the risk-taking capabilities that are made possible by the internal credit rating system, its strong ties with financial institutions through which the Bank finds numerous business opportunities, advanced expertise in handling problem assets, and a sophisticated system for assessing and undertaking appropriate risk grounded in strong capabilities in product development and structuring.

Distressed Assets Business

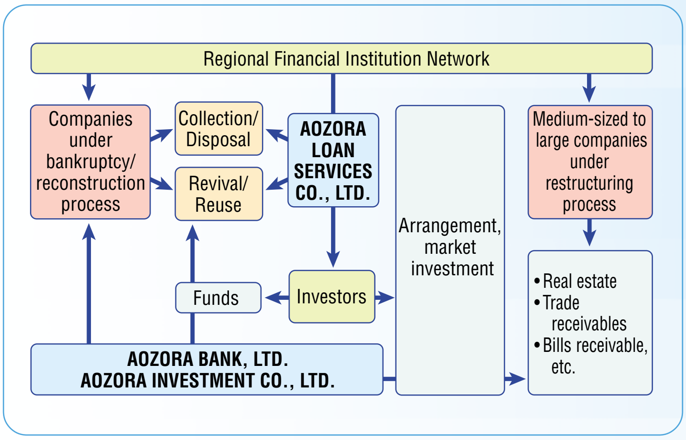
The Bank and its loan servicer subsidiary, AOZORA Loan Services Co., Ltd., provide a range of services aimed at bankrupt companies and companies undergoing corporate reorganization. These include leveraged finance, debtor-in-possession (DIP) financing and advisory services for the formulation of corporate reconstruction plans as well as practical support in carrying out such plans and the purchase of problem loans.

Real Estate Finance

There is strong demand among large and medium-sized companies for assistance in unlocking potential sources of liquidity from existing balance sheet assets, including real estate and notes and accounts receivable. To meet these needs, the Bank provides such services as investments in and loans to special purpose companies (SPCs) established as part of securitization schemes, proposals for asset securitization schemes and offering securitized products to investors.

Project Investment

In addition to its pioneering approach to finance in such areas as content-related industries—movies, publishing and video games—and retail channel expansion, the Bank also provides business restructuring support to start-up companies using its distinctive expertise. The Bank also supports business reorganization through buyout funds.



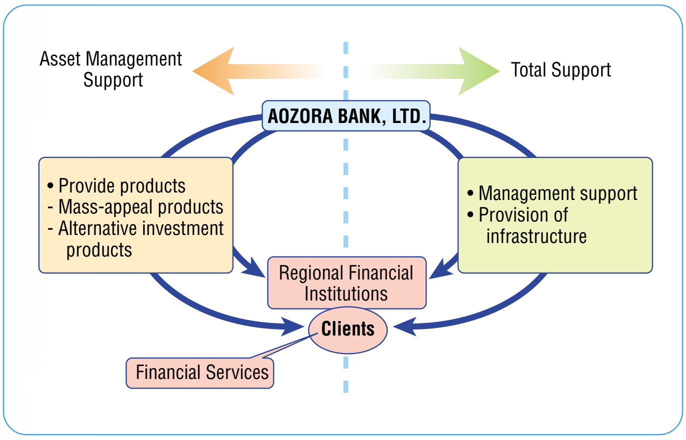
Originating, Structuring and Distributing Financial Products

Utilizing advanced financial technologies, the Bank structures securitized financial products based on assets built up through its operations in finance for medium-sized enterprises and revitalization business as well as assets owned by the Bank's customers. The Bank then provides these products to investors. Know-how accumulated through this process, in such areas as risk management, is then utilized in providing solutions to customer needs.

For customers with fund-raising needs, we offer a diverse array of financing methods, including securitization based on assets owned by the customer, syndicated loans designed and arranged according to particular needs and financing that incorporates the use of derivatives.

For customers with asset management needs, in addition to such mass-appeal products as debentures and public bonds, we offer a wide variety of marketable financial instruments, including syndicated loans customized to meet particular needs, securitized products, products with built-in derivatives and investment funds.

For customers with financial and management needs, such as asset and liability risk management, we provide risk management know-how gained through our lending and revitalization financing operations as well as new types of schemes and products. We can also offer support services through our subsidiary AOZORA Loan Services that utilize that company's specialized solution capabilities.



The Combined Power of Our Three Strategic Areas

Taking advantage of our ability to undertake an optimum level of risk as well as our relationships with financial institution clients

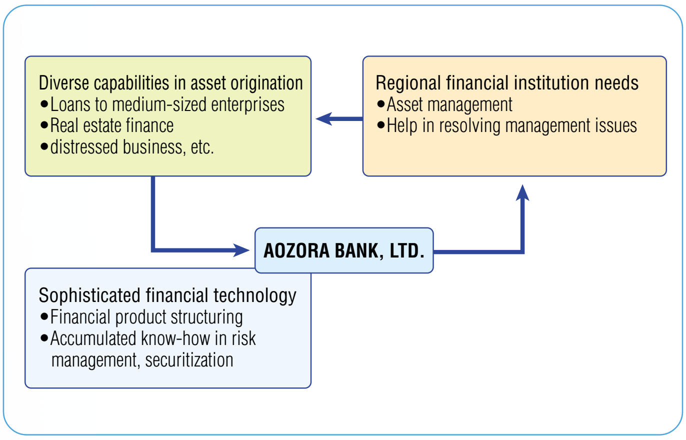
Our ability to closely connect the three strategic focus areas and build a business model that contributes to the revitalization of the Japanese economy rests on two particular characteristics of the Bank. Firstly, its advanced capabilities in assessing and undertaking risk. And secondly, its business relationships with financial institution clients.

The Bank's sophisticated capabilities in undertaking risk are backed up by its strong asset base—borne out by a high capital adequacy ratio—and its ability to accurately assess risk, supported by the internal credit rating system.

The Bank has not only provided asset management products and services—centering on debentures—to financial institutions over many years, but also built close working relationships since the Bank's return to private ownership. A large number of financial institutions with which we have a business relationship have become shareholders of the Bank. We will continue to be a bank that effectively meets the individual needs of financial institutions by providing new financial product solutions to customers' management issues.

Generating synergies among operations

By generating synergies between the three pillars of the Trinity Plan, we plan to enhance our profitability and be recognized as a bank with strong competencies and a high level of expertise. In addition to direct lending, we can propose syndicated loans in collaboration with financial institutions throughout Japan. Furthermore, the assets built up can then be structured into various financial products, to be offered to investors and financial institutions. The Bank is able to provide know-how on risk management acquired through lending and revitalization financing operations. The ties with financial institutions may serve as a tool to seek new business opportunities involving medium-sized enterprise loans, real estate and problem loans.



For Corporate Clients

Aozora Bank's most important objective is to become a truly trustworthy partner for its customers—a bank that can be relied upon to help solve the problems facing its corporate clients. We believe that this can only be achieved when the Bank and the customer have developed a sound mutual understanding. Based on this philosophy, we focus on building long-term relationships, through which we not only share knowledge and information with the customer but also create tailor-made solutions that utilize the full extent of our financial expertise.

To achieve these aims, the Bank employs a unique problem-solving approach to managing customer relationships with both corporate and financial institution clients, particularly focusing on the strategic areas outlined in the Bank's Trinity Plan, and, thereby, benefiting from the resulting synergies that are generated among the different operations. The Bank converts assets built up through its lending and revitalization business operations into financial products, and then provides the products and know-how accumulated through that process to corporate and financial institution clients and their respective business partners. Within this process, rather than offering a "one size fits all" service to our clients, we provide financing and management solutions optimal to the specific needs of each customer.

Corporate Finance

The Bank has traditionally provided high-quality funding solutions through its corporate lending activities. In addition to ordinary lending, for such purposes as investment in plant and equipment and working capital requirements, we offer tailored solutions that draw on a broad lineup of products—including loan syndications, commitment lines of credit and loan/derivative combinations—to meet a diverse range of customer needs. As the business environment undergoes major changes, many medium-sized firms are involved in aggressive reform programs, including the overhaul of existing businesses and entry into new businesses. As outlined in the Trinity Plan, we are primarily focusing on meeting the needs of these types of companies. Based on the principle of pursuing an adequate return for the risk assumed by the Bank, in our risk assessment process we not only take into account tangible asset-based collateral but also accurately assess such factors as the client's technical capabilities as well as the originality and competitive advantage of their business model. In addition, we have established credit risk assessment methods that emphasize customers' cash flow generating capabilities and set up a system for working with customers on risk reduction issues. As a result, we are better able to assess which covenants are appropriate for a particular loan agreement. The Bank also develops and offers optimal financing solutions to meet customers' particular needs. These include the securitization of various types of monetary claims and non-recourse loans focusing on the cash flows from individual projects. As well as promoting the strategic areas contained in the Trinity Plan—revitalization business and originating, structuring and distributing financial products—we are striving to further enhance our solutions-driven approach by offering a diverse range of products and services and developing new financing schemes catering to the different needs of each of our customers.

Revitalization Business

Aozora Bank has developed an integrated set of services to support the revitalization of existing businesses and the incubation of new businesses, on either a whole company or business unit level, helping clients unlock hidden value and add new value. These services encompass such areas as spotlighting and evaluating stagnant businesses and dormant assets within companies.

To achieve these goals, the Bank provides leveraged finance and debtor-in-possession (DIP) finance, advisory services for the formulation of corporate recovery plans and the purchase of problem loans. Non-recourse real estate finance is also included within our range of services. In addition, we provide support for company start-ups, buyouts and business restructuring. This may include arranging finance on an individual project basis for content business development or retail channel expansion.

Leveraged Finance

Aozora Bank is one of the leading providers of leveraged finance in Japan, providing senior and mezzanine debt financing for mergers and acquisitions, management buyouts, leveraged buyouts and recapitalizations. The Bank also provides finance to companies emerging from bankruptcy protection as well as financing of leveraged roll-ups. Our financing is provided on the basis of the cashflow-generating capabilities of the companies to be acquired and the projects to be financed. We have acted as lead or joint lead arranger on various corporate buyout transactions completed by major private equity funds operating in Japan, enabling us to build a solid competitive position in this field.

Recovery Support

For clients needing to respond to a rapidly changing operating environment, the Bank offers a full lineup of business recovery services. In addition to providing a range of corporate advisory services, including the formulation of business recovery plans and assistance in finding new business sponsors, we also provide various types of lending, short-term working capital financing essential for business continuity (DIP finance), and medium- and long-term lending premised on a sound recovery plan, both independently and in collaboration with other financial institutions.

Our loan servicer subsidiary, AOZORA Loan Services, undertakes the following activities: (1) providing support for financial institutions to help them dispose of non-performing loans through the purchase of such loans held by these institutions; (2) providing support for regional financial institutions to help them improve the quality of their loan asset portfolios through a range of advisory services, including the formulation of business recovery plans and business strategies for clients to whom the regional institution has a particular risk exposure; and (3) offering business recovery plan proposals to obligors of loans purchased by AOZORA Loan Services, thereby helping rehabilitate the borrower's business. These activities have been widely recognized by the business recovery industry, recently leading to a representative of AOZORA Loan Services being recommended for the board of the Japanese Association of Turnaround Professionals.

Aozora Bank does not limit itself to domestic-related needs in this area. We are also able to provide expertise and detailed know-how in the liquidation and disposal of overseas assets. For corporate clients reorganizing their overseas operations, we undertake purchases of overseas-based distressed assets and loans to overseas subsidiaries and assist with the divestiture of joint venture shareholdings. For financial institution clients, we offer a range of services, including the purchase of problem loans that have been made to non-resident borrowers.

Real Estate Finance

One of Aozora Bank's core areas of expertise within its revitalization business operations is real estate finance. This does not refer to corporate lending to ordinary developers and real estate companies but to non-recourse financing whereby lenders rely on cash flows generated by the subject assets (real estate).

In recent years, such non-recourse financing methods as real estate securitization have become more common in the Japanese real estate finance sector. Behind this shift are major changes in the traditional patterns of property ownership, management and utlization in Japan. Specifically, many companies, rather than following the traditional route—increasing borrowings on their balance sheet to buy real estate for their own use and which they must manage themselves—are increasingly separating out the functions that they do not wish to perform in relation to their property needs. Under this approach, a property investor owns the real estate assets, which are managed by a specialist property management company, while end users enter into lease agreements for the facilities they wish to use. Larger numbers of investors now consider real estate assets that generate stable cash flows in a similar light to other financial products. At the same time, many companies are actively looking for ways to remove their real estate assets from their balance sheets. Reasons for such moves by corporations include preparation for the adoption of accounting standards relating to the impairment of fixed assets. These trends, which are epitomized by the introduction of Japanese real estate investment trusts (J-REITs) in September 2001, are expected to further accelerate in the future. As of March 31, 2003, there were six publicly listed J-REITs.

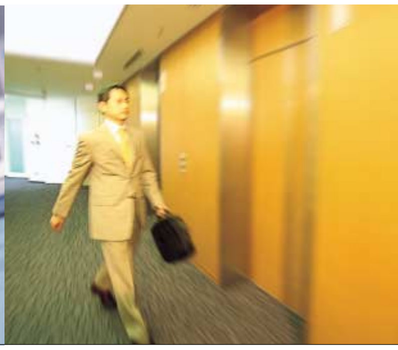
The Bank perceived these market changes at a very early stage and has taken an aggressive approach in developing the real estate non-recourse finance field. This new mode of financing is an area in which the Bank is able to make the best use of its high level of expertise in real estate and cash flow analysis, cultivated over many years as a long-term credit bank. We are also able to provide services as arranger for such transactions by taking advantage of our very broad business network in Japan. From our neutral position, we are able to collaborate with many of the industry's leading arrangers and provide primary lending and investments. We have built up a strong track record in scheme proposals and successfully executed transactions for our own corporate clients as well as for customers of our regional financial institution clients.

The Bank will continue to meet the diverse needs of its customers in the area of real estate ownership, management and utilization by offering a lineup of high value-added services.

Private Equity

Buyout Funds

The Bank supports business restructuring through the use of buyout funds. Through the Business Succession and Second Founding Fund, which is managed by JABOC, Ltd.[1], the Bank is involved in providing buyout investment services to various parties. These include profitable small and medium-sized firms that are unable to find suitable successors for retiring founders, and divisions or subsidiaries of large corporations that are looking to be spun off as independent operations. The Bank has already contributed to the


successful completion of a number of these transactions. In March 2003, JABOC was also involved in the establishment of a new buyout fund, to be managed jointly with a subsidiary of NIF Ventures Co., Ltd.

In addition, we have moved into the area of industry-focused buyout funds. We have jointly established IDA Capital Inc.[2], which in September 2002 set up and now manages Japan's first buyout fund specializing in restructuring in the information systems industry.

Note 1: In August 2001, Japan Asia Investment Co., Ltd. (JAIC), and Aozora Investment Co., Ltd., a fully owned subsidiary of the Bank, established JABOC , Ltd., as a 50:50 joint venture.
Note 2: In August 2002, IDA Capital Inc. was jointly established by Braxton Ltd. (formerly Deloitte Tohmatsu Consulting), ITOCHU Corporation and Aozora Investment.

Project Investment
As part of Aozora Bank's unique approach to content-related industries—movies, publishing and video games—and corporate retail channel expansion, we are supporting the development of new businesses through the establishment of project funds in a joint venture format as well as through direct investment. As an area that has, in the past, been difficult to fund on a corporate basis, we are achieving tangible business financing results on a project basis. Specific examples of the successful application of this strategy include the movies *Ju-on: The Grudge* and *8 femmes,* the video game titles *Detective Saburo Jinguji: Innocent Black* and *The Convenience Store 3,* and the aria blu TOKYO restaurant chain. To date, we have funded over 20 such projects.

Venture Capital Investment
In addition to responding to the particular needs of start-up companies with tailored lending solutions, through Aozora Investment we have achieved positive results in supporting fast-growing new companies and high-quality projects.

As outlined previously, the Bank is committed to providing value-added services to start-up clients as part of our financing initiatives.

Other Services

Hospital Management Assessment Project
In September 2002, the Bank set up the Hospital Management Assessment Project, with the aim of building a comprehensive situation analysis tool and method of testing the adequacy of management strategies, for use in the management of medical institutions. The project team has accumulated significant know-how in this specialized area and provided case-specific, practical feedback to the participating institutions. We will endeavor to further strengthen our operations in this field by focusing on a variety of activities. These include working closely with our regional financial institution clients to utilize and share expertise on the objective assessment and analysis of hospital management, providing financial advisory services to medical institutions and jointly originating syndicated loan transactions. We also design tailor-made financing schemes for medical institution clients, based on a comprehensive analysis of current circumstances and an assessment of future management strategies.

Ship Finance
The Bank provides finance for the construction and purchase of bulk carriers, chemical tankers and other ocean-going vessels, which, in recent years, have increasingly been chartered by non-Japanese shipping lines. Our ship finance group has built up considerable know-how in effectively meeting ship financing needs.

Financial Markets

Aozora Bank provides a wide range of products and services to support customers' financial management needs, offering optimal solutions based on leading-edge techniques in financing, investment and risk control.

Our daily customer interface—the account officers—work closely with financial product specialists in marketing and research and development. This teamwork guarantees the Bank's commitment from product development through sales and origination of deals to final settlements. In this way, we are able to provide tailor-made financial products to our customers.

For clients' financing needs

Loan Syndication

The syndicated loan market continues to expand in Japan as more corporate borrowers diversify their funding sources. Aozora Bank is extending an increasing number of syndicated loans to corporate customers backed by its syndication capabilities based on its long-standing close relationships with regional financial institutions. Recently, we have also introduced syndicated loans to small and medium-sized corporate customers of these regional financial institutions. Through syndicated loans, we not only help customers obtain a new funding source but also help them achieve positive recognition as corporations with a high level of financial management sophistication.

Securitization

Securitization is one of the business areas in which the Bank is strategically concentrating its resources. We have set up a special team of experts in this field, who, in association with Aozora Trust Bank, provide our customers with securitization of various types of financial claims, such as accounts receivable, leaseholds, loans and installments. Securitization of medical fees is one of the Bank's particular strengths. These methods allow our customers to lower their financing costs at the same time as streamlining their balance sheets.

Assistance in Issuing Corporate Bonds

To satisfy clients' financing needs through bond issuance in the capital markets, Aozora Bank acts as trustee of private and public bonds, including the private corporate bonds of small to medium-sized companies guaranteed by the Credit Guarantee Corporation. This trustee service has been developed through the Bank's extensive experience and expertise accumulated as an authorized issuer of and registration agency for bank debentures. In addition, we arrange bond offerings and provide trustee services for asset-backed securities (ABS), the market for which has been expanding rapidly in recent years as a new financing tool for corporations.

Derivative-Embedded Loans

To meet the varied financing needs of our clients, we have developed a number of new types of product. One of these new offerings is Marine Blue, a loan product embedded with various interest rate derivatives, designed for clients who seek lower financing costs and interest rate risk hedging. In addition, we provide customized loans with various types of derivatives to meet our clients' diverse business funding needs.

Commercial Paper

The size of the Japanese commercial paper (CP) market remains significant, and it is the next largest source of short-term funds after the treasury bill (TB) and financial bill (FB) markets. The Bank directly participates in the open market operations of the Bank of Japan, and is actively seeking new CP business. In recent years, many corporate clients have selected Aozora Bank as their CP dealer, and we will continue to actively promote our financing proposals based on our high level of expertise in this field.

For clients' investing needs

To pension fund and investment trust clients as well as regional financial institutions, municipalities and other institutional investors, we offer investment trust and marketable financial instruments, including commercial paper, government-guaranteed bonds and municipal bonds. The Bank also provides its clients with comprehensive, well-researched market information.

Furthermore, in response to growing investment needs as a result of Japan's low interest rate environment, we offer a special time deposit called Mountain Blue, which incorporates derivatives that cover a variety of clients' interest rate scenarios. In addition, we have extended our product lineup to include financial products, such as securitized monetary claims and credit-linked products.

Offering diverse and advanced risk hedging tools

The Bank has built an effective system for providing customers with detailed information and optimal derivative products in a timely manner to help them effectively manage their exposure to market risks (interest rate risk and foreign exchange risk) and credit risk. We are also active in developing new risk management products. The Bank provides a range of foreign exchange and interest rate derivatives, including forward exchange contracts, currency options and interest rate swaps and options. In addition, we are bolstering our capabilities in the area of credit derivatives in response to increasing customer demands for management of their credit risk exposure. The Bank also offers weather derivatives to enable customers to hedge losses caused by unfavorable changes in weather conditions.

Reflecting the harsh economic conditions, many of our clients are currently implementing programs to strengthen their financial base, as well as making efforts to streamline balance sheets, lower financing costs and improve credit portfolio management. By building close relationships and being a reliable partner, Aozora Bank will succeed in its aim of helping its customers achieve these objectives.

Retail Banking

To provide products and services that precisely meet the investment and financial planning needs of our individual customers, we are developing our specialist advisory services to an advanced level. As well as utilizing our branch network, we are improving remote channel access through an expansion of our telephone banking services.

We launched a special time deposit product, available through telephone banking only, called Aozora Direct Time Deposit, bolstered our lineup of life insurance and investment trust products, and also began offering a new credit card loan product. We also focused on expanding our consulting services, including the introduction of services provided by the FP Promotion Department in the Tokyo region, where customers can obtain advice on such issues as investment, estate planning and business succession.

Asset Management Products

Time Deposits

The Aozora Direct Time Deposit, offered exclusively as a telephone banking product, utilizes remote channels to reduce operational costs, enabling us to offer very competitive interest rates. Also attracting many customers to this product is the fact that the deposit and withdrawal of funds can be made through the Postal Savings ATM network and are not subject to ATM usage fees. We also offer time deposit products targeted at senior citizens, including *Sansan* and *Minonaru*.

Debentures

As a debenture-issuing bank, we have a strong track record in meeting the asset management needs of individual customers. We have also launched a new type of debenture called Aozora Super in response to the phasing out of blanket protection of bank deposits by the Japanese government. As of the end of April 2003, we discontinued sales of *Warishin* Aozora discounted debentures and *Risshin* Aozora debentures. For these products, we are now only offering custody services.

Investment Trusts

As of April 2003, we offered a total of 28 investment trust products to meet the diverse investment needs of our customers. These included standard types, such as money market funds (MMFs), corporate and public bond investment trusts, foreign currency MMFs, and bonds and equities-based investment trusts (domestic and foreign) as well as more specialized varieties, including funds that provide monthly performance-based returns.

Life Insurance Policies

From October 2002, the Bank began over-the-counter sales of personal life insurance pension products, following the repeal of a regulatory ban on such sales.

Loan Products and Services

Credit Card Loans

Aozora Card Co., Ltd., a joint venture established with the ORIX Group, commenced operations in April 2002. The company's main line of business is unsecured loans to individuals, but is also involved in credit guaranty operations for personal loans made by regional financial institutions. Our loan credit card, MY ONE, offers a range of advantages to customers, including high loan credit limits, low interest rates, 24-hour service and the convenience of a large ATM network. This product is mainly targeted at consumers in the 30-to-49 age-group. So far, usage of the product's Internet marketing channel has been well ahead of our original forecasts.

Aozora Financial Garden

Aozora Financial Gardens are a new feature of our branches in the Tokyo region. Specialist staff provide advisory and consultation services to individual customers covering a range of topics, including investment, real estate asset management, home buying and loans.

Service Channels

Telephone Banking

As well as providing exclusive access to the Aozora Direct Time Deposit product, our telephone banking service also lets customers purchase investment trusts and debentures and take care of normal personal banking procedures, such as account balance inquiries and change of address notifications. To further increase the attractiveness of our remote banking channels, we intend to continue adding new products and services on a regular basis.

ATM Alliances

To further enhance customer convenience, we extended our ATM alliances to include Postal Savings ATMs across Japan, in addition to our existing ATM alliances with the major nationwide banking groups and trust banks. At Postal Savings ATMs, Aozora Bank customers can make deposits and withdrawals seven days a week, without incurring usage fees.

Consulting Services

To strengthen our ability to provide a range of asset management consulting services at our branches, we have put in place a system to encourage and support staff members in obtaining financial planner qualifications. To increase customer convenience in accessing these services we have extended the hours of our consulting services to 5:00 p.m. on weekdays at the Bank's headquarters and all branches. We also offer free consultations with lawyers and tax accountants.

In February 2003, we established the FP Promotion Department at the Bank's headquarters to provide a range of specialist consultation and advisory services to customers in the greater Tokyo metropolitan area. These services cover such areas as asset management, estate planning and business succession, with the aim of providing the information necessary for customers to make the best choices regarding their financial needs.

Disposal of Problem Loans and Analysis of Assets

Disclosure of Claims under the Financial Reconstruction Law (Improvement of Asset Quality)

The Bank is addressing the disposal of problem loans as one of management's key tasks. Based on stringent internal self-assessment standards, the Bank makes the appropriate write-offs and reserve provisions, and carries out the disposal of problem loans where that is deemed optimal, after considering a course of action for each individual problem loan.

In the fiscal year ended March 31, 2003, disclosed claims under the Financial Reconstruction Law amounted to ¥202.5 billion, a significant reduction compared with the ¥489.6 billion disclosed at the end of the previous period. This decrease was the result of a combination of measures aimed at removing such assets from the Bank's balance sheet, including the collection of problem loans, the sale of some claims and write-offs. As a result, the disclosed claim ratio fell from 14.19% at the end of the previous period to 5.97% as of March 31, 2003. The Bank will continue to pursue the disposal of problem loans.

Disclosed Claims Pursuant to the Financial Reconstruction Law

(Billions of Yen)

	2003	2002	Change
Disclosed claims pursuant to the Financial Reconstruction Law:			
Bankrupt and similar credit	13.5	21.1	(7.6)
Doubtful credit	93.3	306.4	(213.1)
Substandard credit	95.7	162.1	(66.4)
Subtotal (A)	202.5	489.6	(287.1)
Normal credit	3,186.1	2,960.3	225.7
Total credit (B)	3.388.6	3,449.9	(61.3)
(A/B)	5.97%	14.19%	(8.22%)

Under the Financial Reconstruction Law, the Bank discloses claims classified into four categories: bankrupt and similar, doubtful, substandard and normal. In this report, "Disclosed claims" refers to the total of bankrupt and similar, doubtful and substandard claims. The "Disclosed claims ratio" refers to disclosed claims as a percentage of total credit held by the Bank.

* Disclosed claims pursuant to the Financial Reconstruction Law include loans, securities loaned, foreign exchange, customers' liabilities for acceptances and guarantees and accrued interest and suspense payments included in other assets.

Removal of Doubtful and Bankrupt and Similar Claims from the Balance Sheet

The Bank has endeavored to effectively and rapidly reduce the amount of problem loans on its balance sheet, employing a variety of methods within an economically rational approach. During the fiscal year ended March 31, 2003, claims newly classified as bankrupt/de facto bankrupt or doubtful, within disclosed claims under the Financial Reconstruction Law, totaled ¥84.4 billion, while liquidated and written-off claims in the same two categories amounted to ¥305.0 billion. As a result, total claims in these two categories as of March 31, 2003, fell ¥220.7 billion compared with the end of the previous period. The Bank has already removed a large proportion—approximately 90%—of outstanding claims against bankrupt or de facto bankrupt and doubtful obligors from its books. This has been achieved by formulating a disposal plan for each individual obligor, thereby carrying out the disposal of loans in a well-planned manner.

Removal of Doubtful and Bankrupt and Similar Claims from the Balance Sheet

(Billions of Yen)

	2003	2002
Disposals through borrower liquidation	(61.1)	(1.9)
Disposals through borrower reorganization	(0.4)	(9.3)
Reductions due to improvement in borrower performance	(35.6)	—
Loan sales to secondary market	(183.1)	(155.8)
Write-offs	7.5	(9.9)
Other (recovery, repayment)	(32.4)	(45.7)
Subtotal (A)	(305.0)	(222.9)
Claims newly classified as:		
Bankrupt and similar	14.2	10.3
Doubtful	70.2	181.4
Subtotal (B)	84.4	191.8
Total (A+B)	(220.7)	(31.1)

Notes: 1. Amounts shown are the sum of amounts for the first half and second half of each fiscal period.
2. Disposals through borrower liquidation: discharge and write-off of claims against borrowers undergoing bankruptcy liquidation; Disposals through borrower reorganization: discharge of claims against borrowers undergoing bankruptcy reorganization and abandonment of claims against borrowers undergoing private resolution; Other: recovery through disposal of collateral and improvement in borrower position
3. For claims written off, where the borrower subsequently undergoes legal or private resolution leading to claim discharge or abandonment, the written-off amount is reduced accordingly and then recorded as either a disposal through borrower liquidation or a disposal through borrower reorganization.

Self-Assessments, Write-Offs and Reserves

Self-assessments, which involve an examination of asset quality and probability of collection for each of its assets, are conducted by the Bank based on internal self-assessment standards developed in accordance with the Financial Supervisory Agency's *Financial Inspection Manual.* Self-assessments are the basis on which the Bank carries out the appropriate write-offs and reserve provisions to preserve the soundness of its assets.

Self-assessments divide borrowers into five categories. Assets are then classified into four categories according to the probability of collection, which is assessed by taking into account any underlying collateral, guarantees or other security. (Please refer to page 21 for Definitions of Borrower Categories, Definitions of Asset Classifications and Write-Off and Reserve Provision Rules.)

As of March 31, 2003, reserve provision ratios for each category of borrower, based on self-assessments, were as follows.

Reserve Provision Ratios for Each Category of Borrower, Based on Self-Assessments

(%)

Definition of Borrower Categories	2003	2002
Normal	1.8	1.4
Watch list:		
Other watch list borrowers	19.7	21.0
Substandard borrowers (Portion of reserves for non-secured)	58.1	56.2
Potentially bankrupt (Portion of reserves for non-secured)	86.9	90.2
Substantially bankrupt and bankrupt (Portion of reserves for non-secured)	100.0	100.0

Credit-Related Expenses

In the fiscal year ended March 31, 2003, the Bank recorded losses arising from the write-off of loans, the sale of claims and other measures that were part of its efforts to dispose of problem loans. In addition, as a result of a net reversal of reserve provisions made in previous periods, thanks to sufficient reserve coverage and the improvement of asset quality, credit-related expenses for the period under review amounted to a surplus of ¥1.4 billion.

Credit-Related Expenses

(Billions of Yen)

	2003	2002
Expenses for the disposal of problem loans	7.1	17.7
Loan write-offs	11.9	4.8
Provision to (reversal of) specific reserve	(10.2)	10.6
Provision for country risk reserve	0.7	0.7
Loss on the sale of other receivables and other items	4.6	1.6
Provision to (reversal of) general loan-loss reserve	(8.5)	(14.7)
Credit-related expenses	(1.4)	3.0

Coverage Ratios of Disclosed Claims under the Financial Reconstruction Law

Total disclosed claims under the Financial Reconstruction Law amounted to ¥202.5 billion, while reserve provisions, collateral and guarantees amounted to ¥173.5 billion, resulting in a coverage ratio of 85.7%.

Disclosed Claims Pursuant to the Financial Reconstruction Law (After Partial and Direct Write-Offs, Non-Consolidated Basis)

(Billions of Yen)

	2003	2002
Disclosed claims under the Financial Reconstruction Law (A)	202.5	489.6
Normal credit	3,186.1	2,960.3
Total credit (B)	3,388.6	3,449.9
Credit secured:		
Reserve for possible loan losses (C)	60.3	174.8
Collateral and guarantees (D)	113.2	256.9
Total (E=C+D)	173.5	431.7
Coverage ratio (E/A)	85.7%	88.2%
Reserve ratio (C/(A-D))	67.5%	75.1%

Note: Reserve for possible loan losses (C) is the sum of provisions to the specific reserve for possible loan losses on disclosed claims under the Financial Reconstruction Law plus general loan-loss reserve.

Self-Assessment, Disclosed Claims, Write-Offs, Reserves and Risk-Monitored Loans (After Partial and Direct Write-Offs, Non-Consolidated Basis)

(Billions of Yen)

Borrower categories for self-assessment	Disclosed claims pursuant to the Financial Reconstruction Law (Total loans / Other)	Reserve, coverage for claims under the Financial Reconstruction Law	Percentage of reserves for non-secured credit	Percentage of credit secured	Risk-monitored loans
Bankrupt borrower Substantially bankrupt borrower	Bankrupt and similar credit 13.5	Collateral and guarantees 13.5 (Partial, direct write-offs 12.8)	(100.0%)	100.0%	Loans to bankrupt companies 9.2
Potentially bankrupt borrower	Doubtful credit 93.3	Collateral and guarantees 65.2 Reserve 24.5 Expected recovery amount 3.7	86.9%	96.1%	Past due loans 99.0
Watch list borrower	Substandard credit 95.7	Collateral and guarantees 34.5 Reserve 35.9 Expected recovery amount 25.3	58.6%	73.5%	Loans overdue for three months or more 1.3 Restructured loans 90.2
Normal borrower	(Normal credit 3,186.1)				

Disclosed claims pursuant to the Financial Reconstruction Law 202.5	Collateral and guarantees 113.2 Reserve 60.3 Expected recovery amount 29.0	Reserve ratio for disclosed claims under the Financial Reconstruction Law 67.5%	Coverage ratio for disclosed claims under the Financial Reconstruction Law 85.7%	Risk-monitored loans 199.7
Total credit 3,388.6	Total reserve 199.3			

Reserve ratio for non-secured portion = Reserve ÷ (Claims – Collateral and guarantees)
Coverage ratio = (Collateral and guarantees + Reserve) ÷ Claims

Risk-Monitored Loans

In addition to disclosed claims under the Financial Reconstruction Law, the Bank also discloses risk-monitored loans under the Banking Law. As of March 31, 2003, risk-monitored loans (on a non-consolidated basis) amounted to ¥199.7 billion, compared with ¥487.7 billion at the end of the previous period.

Risk-Monitored Loans (After Partial and Direct Write-Offs)

<Non-Consolidated>

(Billions of Yen)

	2003	2002
Risk-monitored loans:		
Loans to bankrupt companies	9.2	18.3
Past due loans	99.0	313.6
Loans overdue for three months or more	1.3	1.6
Restructured loans	90.2	154.3
Total (A)	199.7	487.7
Year-end balance of total loans (B)	3,271.1	3,304.4
(A/B)	6.1%	14.8%

<Consolidated>

(Billions of Yen)

	2003	2002
Risk-monitored loans:		
Loans to bankrupt companies	9.2	18.3
Past due loans	99.0	313.6
Loans overdue for three months or more	1.3	1.6
Restructured loans	90.2	154.3
Total (A)	199.8	487.7
Year-end balance of total loans (B)	3,258.7	3,298.0
(A/B)	6.1%	14.8%

<Definitions of Borrower Categories>

Normal	Business performance is strong and no special financial problems exist.
Watch list	Borrowers that need to be monitored carefully because of weak business fundamentals, financial problems or problematic lending conditions.
Potentially bankrupt	Borrowers that are not currently bankrupt but are highly likely to become bankrupt.
Substantially bankrupt	Borrowers that are substantially bankrupt but are not legally or practically bankrupt yet.
Bankrupt	Borrowers that are legally or practically bankrupt.

<Definitions of Asset Classifications>

Category I	Assets that present no particular risk of collectability nor impairment of value.
Category II	Assets, including credits, which bear above-average risk of collectability.
Category III	Assets that bear substantial risk of final collectability or impairment of value, and are likely to incur losses.
Category IV	Assets deemed to be uncollectable or valueless.

<Write-Off and Reserve Provision Rules>

Normal and watch list borrowers	Based on historical bankruptcy rates, normal status borrowers, special attention borrowers and other watch list borrowers are classified and across-the-board provisions are made to the general loan-loss reserve.
Potentially bankrupt borrowers	For each borrower, the expected recovery amount of category III assets (non-secured portion) is estimated and a provision is made to the specific loan-loss reserve for the amount of shortfall. The expected recovery amount is the discounted present value of the estimated cash flows from future recovery of the loan principal.
Substantially bankrupt and bankrupt borrowers	The full amounts of category III and IV credits are written off directly.

<Definitions of Disclosed Claims Pursuant to the Financial Reconstruction Law>

Bankrupt and similar credit	Bankrupt and de facto bankrupt refers to the credit of borrowers who are in a state of bankruptcy, corporate reorganization, composition, etc., and the equivalent thereof.
Doubtful credit	Doubtful refers to credit with serious doubt concerning the recovery of principal and receiving of interest as contract provisions, because the borrower's financial condition and business results have worsened, although they have not reached the point of management collapse.
Substandard credit	Special attention refers to loans in arrears for more than three months or with mitigated conditions.
Normal credit	Normal credit refers to credit to borrowers whose financial condition and business results have no particular problem and which are not categorized in any of the above categories.

<Risk-Monitored Loans>

Loans to bankrupt companies

Loans to bankrupt companies are loans for which interest in arrears has not been accrued because recovery or settlement of principal or interest is unlikely due to the prolonged delay in payment of principal or interest (which hereafter shall be called "non-accrual loans") and whose borrowers are legally bankrupt (defined below), excluding the amount of write-offs.

1. Borrowers that have applied for commencement of company or financial institution reorganization procedures pursuant to the provisions of the Corporate Reorganization Law.
2. Borrowers that have applied for reorganization pursuant to the provisions of the Civil Reorganization Law.
3. Borrowers that have applied for bankruptcy pursuant to the provisions of the Bankruptcy Law.
4. Borrowers that have applied to commence liquidation or special liquidation pursuant to the provisions of the Commercial Law.
5. Borrowers with reasons equivalent to 1. to 4. above as defined by Ministry of Finance ordinances.
6. Borrowers who have applied for commencement of legal liquidation procedures pursuant to overseas laws, corresponding to those listed above.

Past due loans	Past due loans refer to non-accrual loans except those for which concessions on payment of interest were made in order to assist the reorganization of bankrupt companies and loans to them.
Loans overdue for three months or more	Loans overdue for three months or more refers to those loans, excluding loans to bankrupt companies and past due loans for which principal or interest remains unpaid for at least three months.
Restructured loans	Restructured loans refer to those loans, excluding loans to bankrupt companies, past due loans and loans overdue for three months or more for which agreement was made to provide reduction or a moratorium on interest payments, or concessions in the borrower's favor on interest or principal payments or to waive claims for the purpose of assisting the reconstruction of insolvent borrowers.

<Differences between Disclosed Claims Pursuant to the Financial Reconstruction Law and Risk-Monitored Loans>

- **Disclosed Claims**

Disclosure:	Loans and other claims (securities loaned, foreign exchange, suspense payments, etc.)
Disclosed:	By borrower (by loan for substandard credit)

- **Risk-Monitored Loans**

Disclosure:	Loans only
Disclosed:	By loan

Progress in Implementing the Business Revitalization Plan

Aozora Bank views, as one of its major business priorities, the achievement of the targets outlined in its Business Revitalization Plan—a medium-term corporate program formulated in accordance with the Financial Function Early Strengthening Law. In the fiscal year ended March 31, 2003, the Bank reached almost all the major targets for the period set out in the plan.

Gross business profit (on a non-consolidated basis) for the period totaled ¥72.2 billion, which was ¥7.5 billion higher than the previous period. This result reflected the Bank's successful efforts in building a sound portfolio of loan assets as well as its focus on expanding non-interest income derived from fee-based business. Within gross business profit, net fees and commissions, net trading revenues and net other operating income all increased compared with the previous period.

General and administrative expenses amounted to ¥38.7 billion, significantly outperforming the Business Revitalization Plan target of ¥41.5 billion. This result was attributable to a broad range of cost cutting measures, including lower branch and office rental expenses owing to relocations and reallocation of space, as well as a reassessment of other expenses.

Consequently, business profit before general loan-loss reserve (on a non-consolidated basis) amounted to ¥33.5 billion and net income after income taxes (on a non-consolidated basis) totaled ¥22.9 billion. Both these results exceeded their respective Business Revitalization Plan targets.

As of March 31, 2003, the consolidated capital adequacy ratio (domestic standard) was 13.30% and the consolidated Tier I capital ratio (domestic standard) stood at 12.51%.

In lending activities targeted at domestic clients, the Bank actively sought to attract new customers, particularly in the area of small and medium-sized firms, while, at the same time, aggressively dealing with the disposal of problem loans. Through an understanding of the needs of its customers, the Bank will be in a strong position to assist small and medium-sized firms and others to meet their funding needs in a timely manner.

In 2003, the Bank is working on the biennial revision of its Business Revitalization Plan as required by the Financial Services Agency (FSA). To ensure the repayment of public funds, the Bank will focus its efforts on adequately meeting the targets set out in the Business Revitalization Plan.

Business Revitalization Plan

(Billions of Yen)

	2001	2002	2003		2004	2005
Years ended/ending March 31,	**Result**	**Result**	**Result**	**Plan**	**Plan**	**Plan**
Gross business profit	56.7	64.7	72.2	73.5	81.5	97.0
General and administrative expenses	40.0	38.8	38.7	41.5	41.5	42.0
Business profit before general loan-loss reserve	16.7	25.9	33.5	32.0	40.0	55.0
Net income after income taxes	99.6	18.6	22.9	22.0	34.0	50.0
Loans and bills discounted (average balance)	3,475.5	3,439.5	3,272.6	3,560.0	3,790.0	4,030.0
Total assets (average balance)	6,907.6	5,791.4	5,718.6	5,620.0	5,870.0	6,160.0
Consolidated Tier I ratio (domestic standard)	13.36%	12.88%	12.51%	12.14%	12.18%	12.46%
Consolidated capital adequacy ratio (domestic standard)	15.13%	14.05%	13.30%	12.92%	12.85%	13.08%

Note: Targets set out in the Business Revitalization Plan were announced in August 2001.

Corporate Governance System

For Aozora Bank, the establishment of a sound and transparent management system is an issue of paramount importance. Following its launch in September 2000, the new Bank introduced the system of corporate governance outlined below.

Separation of Responsibilities

Executive functions have been delegated by the Board of Directors to the Executive Committee.

- The day-to-day running of the Bank's operations have been delegated by the Board of Directors to the Executive Committee. The Bank's president, acting in his role as chief executive officer, chairs the Executive Committee, which comprises all the executive officers of the Bank. As the highest decision-making body for operations, the Executive Committee is tasked with raising the Bank's operational effectiveness and expeditiousness.
- The Board of Directors determines the basic management policies and strategies of the Bank. By delegating the day-to-day operational functions to the Executive Committee, the Board of Directors is able to focus more on the broader strategic issues faced by the Bank.

An Enhanced System of Checks and Balances

The system of checks and balances at the Bank is not limited to checks on the Board of Directors by the Corporate Auditors and Board of Corporate Auditors, as required under Japan's laws and regulations. The system has been significantly enhanced by a range of measures, including (1) the appointment of directors from outside the Bank; (2) the establishment of the Nomination and Remuneration Committee; and (3) the establishment of the Internal Audit Committee.

- People possessing a wide range of experience—from the business community and elsewhere—have been appointed to the Board of Directors. As well as acting as a necessary check on operational management, the Board of Directors is able to make decisions based on a very diverse set of perspectives.
- The Nomination and Remuneration Committee is an advisory body to the Board of Directors comprising outside directors. It makes recommendations to the Board of Directors regarding the appointment and dismissal of directors and executive officers, and also conducts remuneration assessments for those directors and officers.

Measures to Avoid Becoming a Captive Bank

The Bank has systems in place to prevent particular shareholders from gaining preferential treatment.

- The Internal Audit Committee was established to ensure the independence and soundness of the Bank's management and enhance safeguards to prevent particular shareholders from gaining preferential treatment. The committee is comprised of directors and corporate auditors not representing specific shareholders and audits transactions between the Bank and major shareholders to prevent the Bank from becoming "captured" by any major shareholder. Transactions with major shareholders and their affiliates are disclosed in the Bank's annual reports as well as when the Bank's financial results are announced.

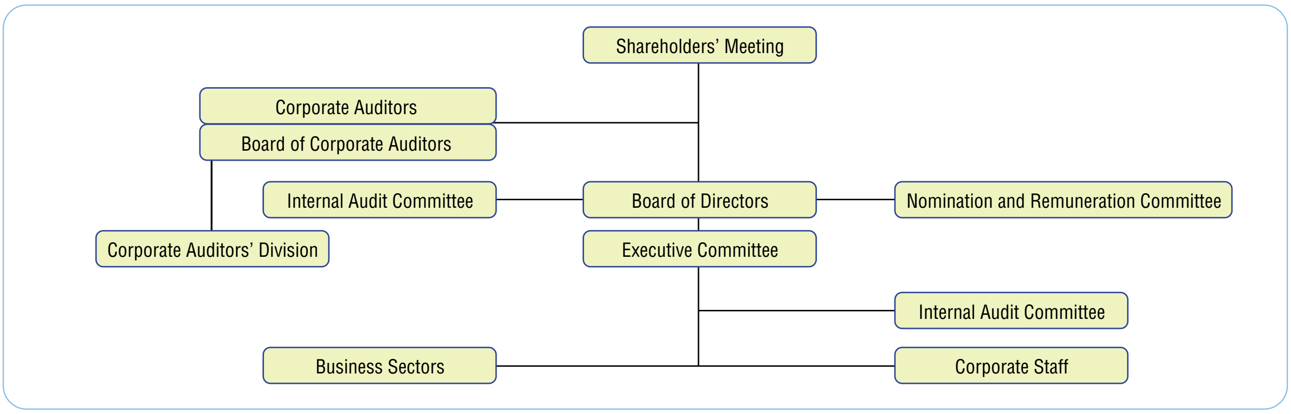
Transactions with Parent Company Groups

(Millions of Yen)

		March 31, 2003	March 31, 2002
SOFTBANK Group	Number of borrowers	6	5
	Credit balance	14,553	15,530
ORIX Group	Number of borrowers	12	13
	Credit balance	31,605	34,497
The Tokio Marine and Fire Insurance Group	Number of borrowers	2	2
	Credit balance	812	381
Cerberus Group	Number of borrowers	—	—
	Credit balance	—	—
Total	Number of borrowers	20	20
	Credit balance	46,970	50,408

Notes: 1. Figures for credit balances refer to credit extended by Aozora Bank, its subsidiaries and affiliated companies.
2. The Bank's "parent companies" refers specifically to major shareholders and their subsidiaries and affiliated companies.
3. Transactions with major shareholders and other firms include loans, customers' liabilities for acceptances and guarantees, commercial paper, equity holdings/interest and derivative transactions.

Management Organization Chart



Risk Management System

An Overview of Risk Management

Basic Policies

Risk management is a priority issue for the Bank, as it lies at the heart of reliable, sound bank management and the achievement of long-term earnings targets. For this reason, the Bank has taken a consistent approach to building an effective and adequate risk management system.

The operation of a bank involves exposure to a variety of risks. Within these, there are those types of risk that are necessary to raise the Bank's profitability and those types of risk that may be reduced by re-engineering certain business processes. The Bank believes it is important to properly identify each type of risk and adequately manage them, taking into account the overall soundness and profitability of the Bank.

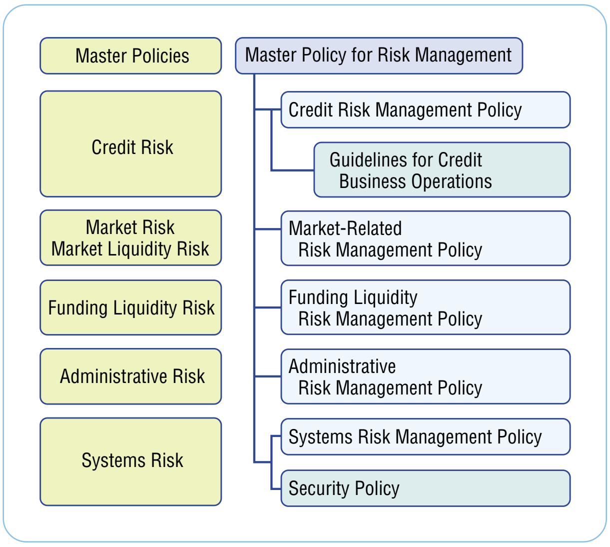
Risk Management System

The Bank's overall risk management policy is clearly explained in its *Master Policy for Risk Management*. As well as determining the basic rules for managing risk, the Board of Directors also sets the risk management framework for the Bank, including capital allocation and the setting of risk limits for the Bank.

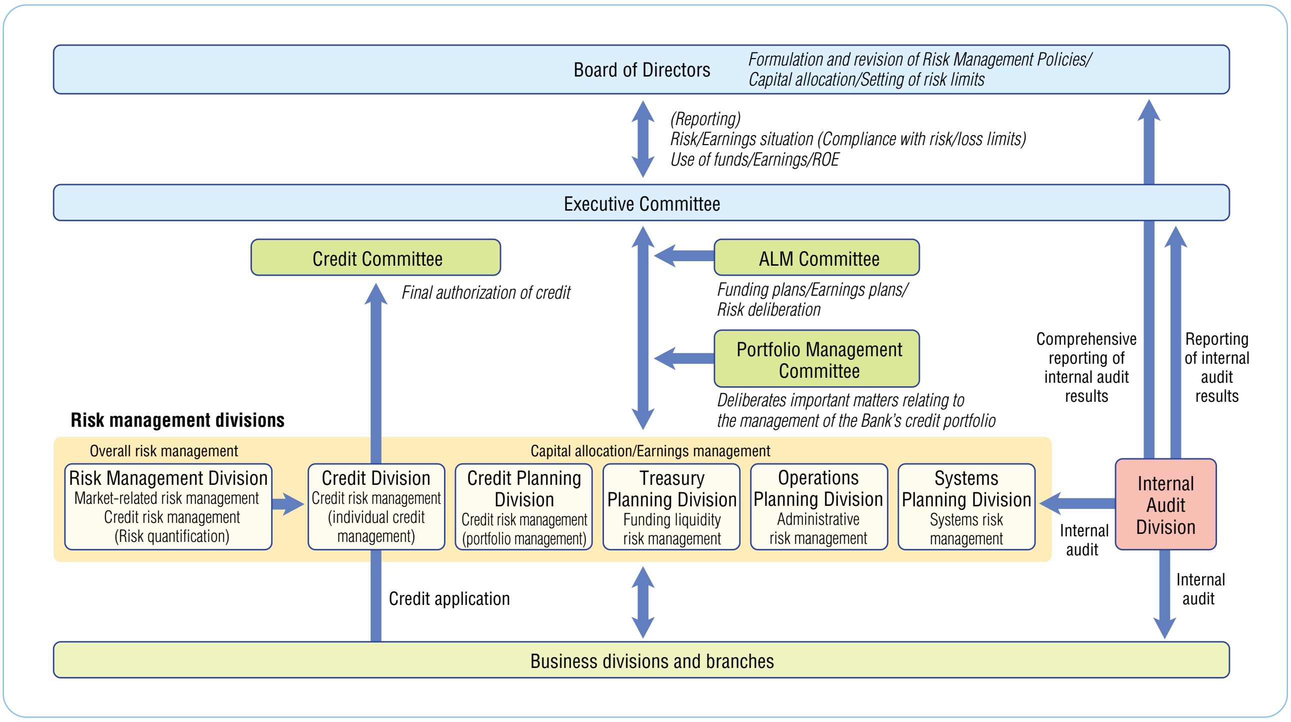
Within this framework, each specialist division manages those risks unique to its business according to their particular characteristics, including credit risk and market risk. The Risk Management Division oversees the risk management system of the entire Bank, strengthens the Bankwide risk management system and comprehensively manages risk by quantifying risks. In addition, the Internal Audit Division checks the appropriateness and effectiveness of the risk management system.

The Board of Directors and the Executive Committee receive reports on the risk management situation at each risk jurisdiction as well as from the Internal Audit Division and utilize this information in management decision making. These management bodies also act to maintain and enhance the Bank's risk management system.

Risk Management Policies



Risk Management System



Quantification of Total Risk

In order to understand different forms of risk comprehensively, risks must be measured by a common yardstick. Aozora Bank employs VaR (Value-at-Risk) to calculate the amount of capital that should be set aside against particular risks. In this way, the Bank undertakes comprehensive management of credit, market and other forms of risk. Risks related to the Bank's affiliates have also been incorporated into this risk management framework.

Capital Allocation System

At Aozora Bank, the capital allocation system sets the amount of capital to be placed at risk by each business unit based on risk tolerance and expected income of each business unit, according to management and business strategies.

The Board of Directors allocates capital (Tier I) to individual business units in line with the requirements of management and business strategies, after setting aside the amount of capital required to maintain minimum capital adequacy and provisions for operational risks.

The amount of capital allocated to business units determines both credit and market risk limits for each business unit. Each unit is then responsible for conducting operations within the risk limit provided by the capital allocation. The Risk Management Division monitors the usage of risk limits by each business unit and reports to senior management. The return on equity (ROE) and risk-return profiles for each business unit are evaluated. This information is reflected in subsequent capital allocation and the formulation of management strategy, with a view to improving the profitability and efficiency of the Bank as a whole.

Credit Risk Management

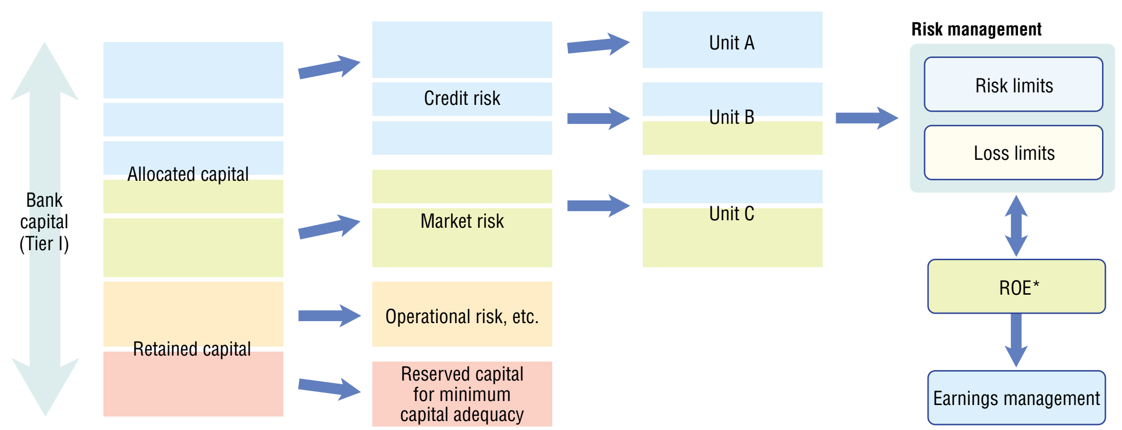
Credit risk refers to the potential for losses arising from the impairment of asset value due to the deterioration of borrowers' financial condition or their failure to perform their contractual obligations for specific projects. The nature of credit risk is becoming increasingly complex, involving issues beyond those that accompany traditional lending operations. The Bank is now exposed to diverse risks, such as risks associated with derivative transactions and settlements.

There are two major components of the Bank's credit risk management. One is the strict credit screening and monitoring of individual transactions. The other is portfolio management, which focuses on eliminating concentration risk and optimizing risk-return profiles. Both contribute to the Bank's efforts to maintain a sound asset base.

Credit Risk Management System

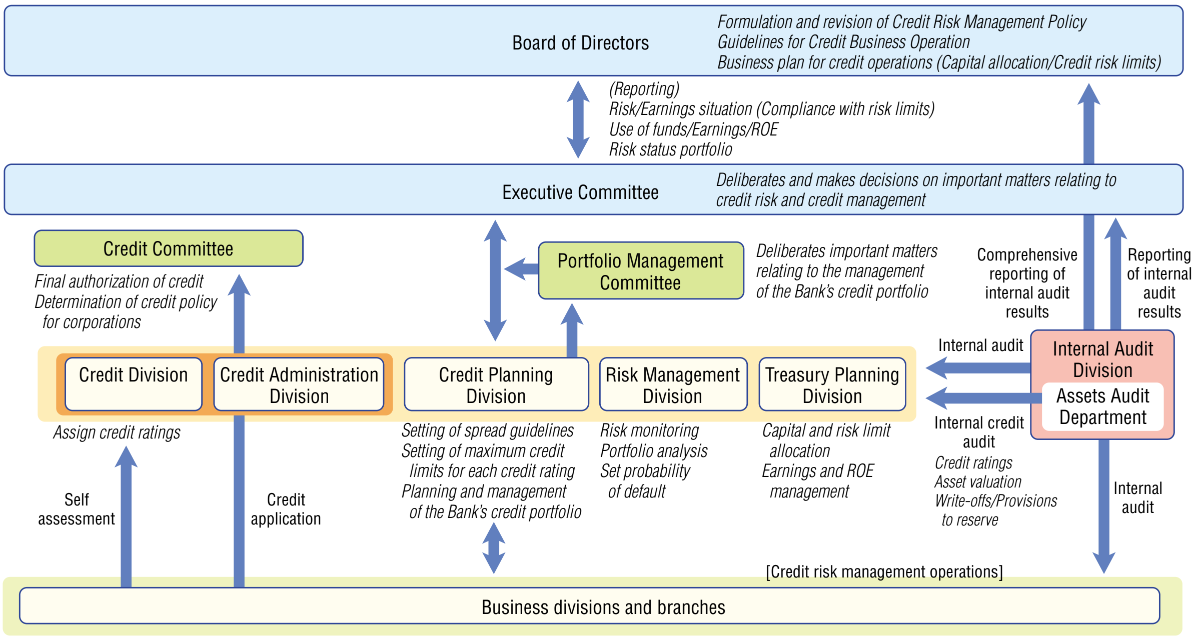
Important policies and rules relating to credit risk are discussed by the Portfolio Management Committee, with decisions on such matters taken by such senior management bodies as the Board of Directors or the Executive Committee. The Portfolio Management Committee comprises directors of the Bank and executive officers responsible for related divisions. In addition, the Credit Committee, which includes representative directors and executive officers in charge

Capital Allocation (Capital at Risk, ROE)



*ROE (Return on equity): The ratio of earnings to capital. Based on a risk capital approach, we allocate capital to each business unit and observe the ratio of each unit's profit and loss (after deducting the cost of credit) to such allocated capital, as one of the reference indices for management. Used as a synonymous concept with risk-adjusted return on capital (RAROC).

Credit Risk Management System



of the Risk Management Division and the Credit Division, approves credit that meets predetermined criteria and formulates guidelines for borrowers with large credit balances.

The Credit Planning Division drafts and sets policies and rules from the perspective of credit portfolio operation and management, while the Credit Division assigns credit ratings to individual customers and screens individual transactions that involve credit risk. To ensure an appropriate system of checks and balances, the Risk Management Division, which is independent of the aforementioned divisions, monitors portfolio risk using quantitative and other methods and provides reports and advice to the Board of Directors and the Executive Committee on the Bank's risk exposure.

Credit Rating System

The Bank's credit rating system dates back to 1991. With the exception of individual retail clients, customer credit

Credit Rating System at a Glance

Borrower categories	Domestic non-financial corporations	Domestic financial institutions	Overseas borrowers	Foreign financial institutions	Countries	Structured finance, etc.		Common probability of default (%)		External rating agencies	Credit research firms
Normal borrowers	A1	F-A1	G-A1	GF-A1	AAA	(Note)		a%			
	A2	F-A2	G-A2	GF-A2	…	…		b%			
	A3						Consistent rating using a common probability of default		Review consistency with external evaluation	External rating	External evaluation
	B1										
	B2+	…	…	…	…	…					
	B2-										
	B3+										
	B3-										
Watch list borrowers (excluding special attention borrowers)	C1+										
	C1-	…	…	…	…	…					
	C2										
Special attention borrowers	C3										
Potentially bankrupt borrowers	D1	…	…	…	…	…					
Substantially bankrupt borrowers	D2							100%			
Bankrupt borrowers	E	F-E	G-E	GF-E				100%			

Note: Ratings in the structured finance category include pooled credit (P-A1), real estate securitization (CM-A1), pooled loan assets (CD-A1), project finance (PF-A1) and LBO/MBOs (L-A1).

ratings are determined on the basis of a quantitative assessment of their financial condition and income, along with an assessment of qualitative factors and consistency with borrower categories as determined by the Bank's internal self-assessment standards.

Credit ratings of Japanese corporations, excluding financial corporations, are divided into 15 categories. At the same time, the credit rating system for other companies has been brought into line with these ratings by matching the probability of default (Note 1) for each category of the former with the latter.

Business divisions and branches conduct a preliminary evaluation of borrowers. Subsequently, the Credit Division is responsible for the final decision. In addition, the Assets Audit Department of the Internal Audit Division and the Bank's external auditor review the appropriateness of the credit ratings during their audit.

Credit ratings are integral to the Bank's credit management. They are utilized in making important decisions on such issues as the scheme for credit approval, the interest rate spread and the credit limit. Credit ratings are also used to conduct the Bank's internal self-assessments and are employed as benchmarks to quantify credit risks.

The Bank constantly reviews the consistency of its own credit ratings with those of external credit rating agencies and the evaluations by credit research firms. The credit rating system is maintained in line with the New Basel Capital Accord (Note 2).

Note 1: The definition of the probability of default is based on a broad interpretation of default that encompasses not only legal bankruptcy and delinquency but also a wider range of circumstances and business conditions.

Note 2: The New Basel Capital Accord is an agreement under deliberation concerning minimum capital requirements. The Basel Committee on Banking Supervision is presently deliberating the accord, with implementation planned for 2006. The accord calls for the use of risk weightings to calculate credit risk assets in a more risk-sensitive manner, and the quantification of operational risk (discussed later) as a risk asset.

Credit Ratings for Individual Transactions

To properly assess the risk-return profiles of each credit, the Bank needs to consider the recovery prospects of individual transactions, in addition to the credit rating of each customer, which reflects the overall creditworthiness of the borrower. For this purpose, the Bank has introduced a system of credit ratings for individual transactions. The system ranks individual transactions according to prospect of recovery, based on such factors as collateral and lending terms, enabling the Bank to calculate the credit cost more precisely. This allows the Bank to offer more appropriate interest rate spreads and lending terms, in full consideration of the credit cost, and thus better control the risk and returns from credit.

Credit Ratings for Individual Transactions with Domestic Corporations (Non-Financial Institutions)

Effective October 2001, the Bank introduced a system of credit ratings for individual transactions for domestic corporations (non-financial institutions). The framework combines the existing borrower credit rating system with an 11-category system of ratings for individual transactions and a six-level classification for the lending term, making approximately 800 different rating combinations. The ratings for individual transactions take into account such factors as cash flows, which are classified by use of funds, and alternative sources of cash. In addition, the rating system allows the Bank to more adequately take into account the nature and value of collateral and guarantees by including the expected cost of recovery, the change in the guarantor's repayment ability over time and the correlation of the guarantor's repayment ability with that of the borrower.

The system of rating individual transactions achieves two goals. First, by laying down clear rules for the credit screening of individual transactions, the important components of the individual transaction are clarified. Second, by focusing on the certainty of the actual sources of funds for repayment of the loan it acts as a bridge to non-recourse financing.

Credit Ratings for Structured Finance Transactions

Since April 2001, the Bank has applied credit ratings to certain financing schemes, such as structured finance, where collection is independent of a borrower's creditworthiness. These credit ratings are applied using different models for each type of financing scheme.

For these transactions, the appropriate risk exposure and credit cost are determined taking into consideration such risks as real estate price fluctuations and risks arising from senior/subordinated loan structures, such as mezzanine debt, and subsequently reflected in the Bank's credit operations.

Credit Screening and Monitoring of Individual Transactions

At Aozora Bank, business divisions and branches are responsible for preliminary screening. The Credit Division then conducts secondary screening, which involves a careful review of customer business plans and verification of the appropriateness of the proposed use of loaned funds. The Credit Division also reviews and assesses the future availability of funds for loan repayment and confirms that the repayment scheme is consistent with the duration of the loan.

Credit monitoring is conducted in accordance with the guidelines stipulated in *Lending Regulations* and the *Credit Management Manual*. The Bank carefully monitors the creditworthiness of borrowers and the value of collateral. In this way, the Bank strives to uncover any problems at an early stage, with the aim of preventing loans from becoming non-performing assets.

The Internal Audit Division performs internal audits of all divisions and branches through on-site monitoring to ensure adequate credit management.

Market Valuation

Investors in Japan are paying increasingly close attention to the disclosure practices of publicly listed firms, as the principle of self-responsibility in regard to investment decisions takes firmer root. This affects credit risk management in two ways. First, a firm's creditworthiness, which cannot be completely grasped through publicly disclosed financial statements, affects the firm's market valuation. And second, changes in a firm's market valuation now have a greater impact on its creditworthiness.

Consequently, the Bank uses market valuation tools to supplement its credit risk management tools. Since December 2001, the Credit Division has used a system of integrated management of market information, including ratings by external credit rating agencies and stock prices, on a daily basis. This information is used to continually evaluate credit ratings in a timely manner and modify the customer relationship strategy if necessary.

Management of Problem Assets

The removal of problem assets from the balance sheet is one of the most critical issues currently facing Japanese financial institutions. To aggressively address this issue, the Bank established the Credit Administration Division to manage problem assets.

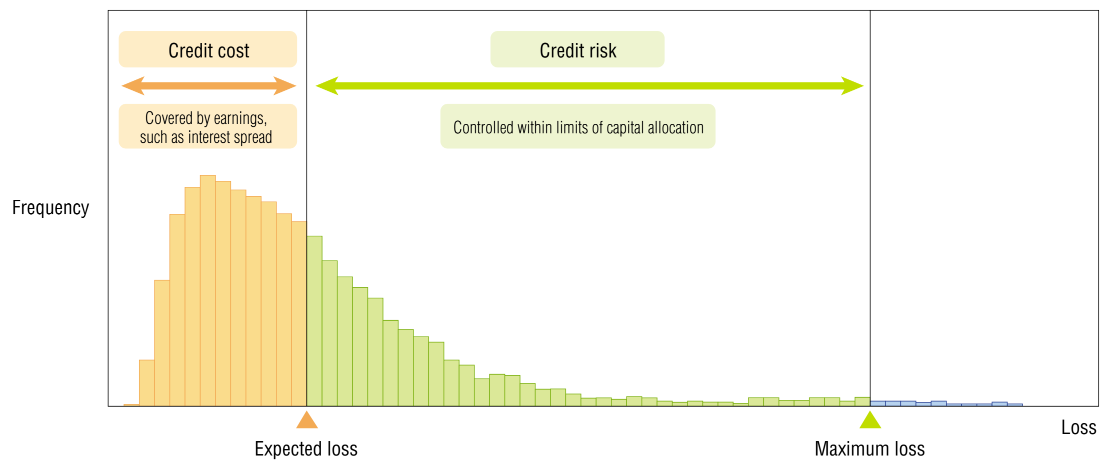
Portfolio Management and Quantification of Credit Risk

The Bank focuses on maintaining the quality of its entire credit portfolio through portfolio management. This includes an analysis and quantification of the aggregate risk exposure of its loan portfolio, in addition to credit risk evaluation and management on an individual borrower and transaction basis.

The Portfolio Management Committee holds discussions based on the results of analysis and monitoring of the Bank's credit portfolio, including the diversity of exposures by industry or by internal credit rating and the concentration of exposures to any corporate group. Based on these discussions, the Board of Directors and the Executive Committee are able to make balanced and informed decisions, reflecting the current status of the Bank's portfolio. This reduces overdependence on credit screening of individual transactions.

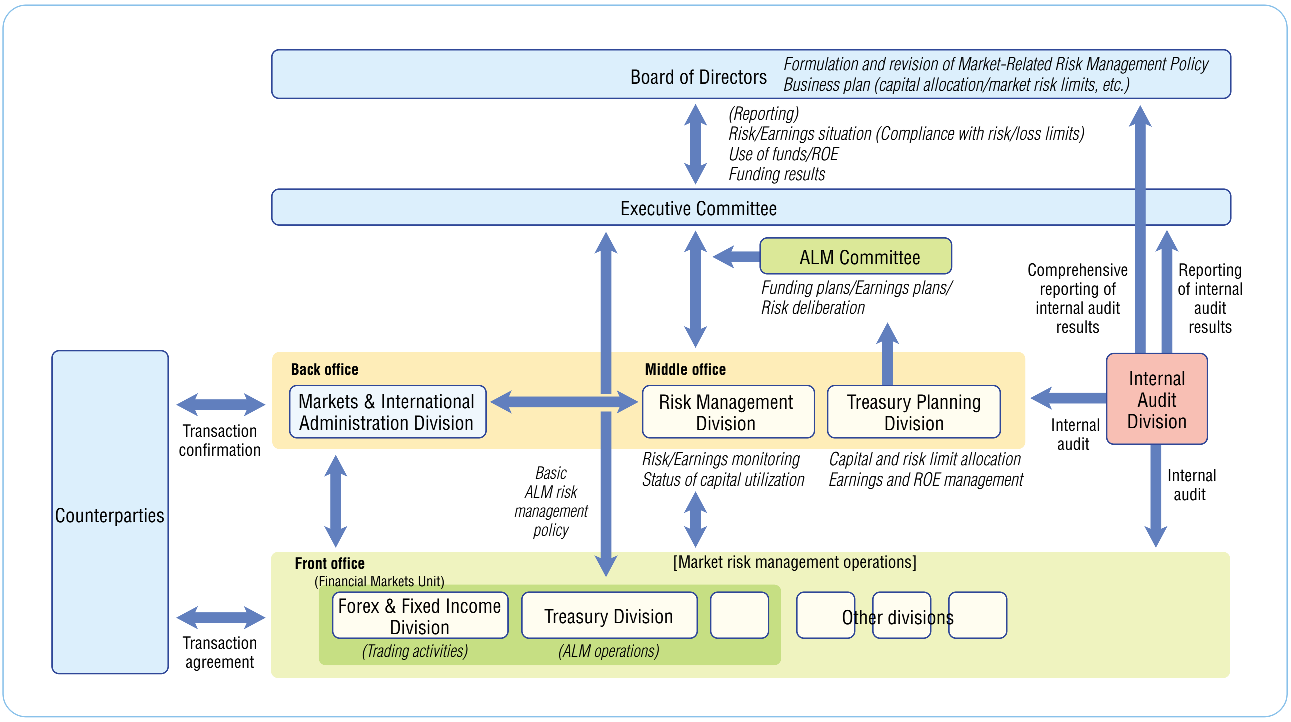
By setting credit ceilings for each credit rating, the Bank ensures that there is no overconcentration of credit in any particular industry or corporate group.

Distribution of Losses for a Credit Portfolio



Note: Using 100,000 possible scenarios, the Bank conducts simulations of potential losses (risk amount) of its portfolio.

Market Risk Management System



Quantifying Credit Risk

Portfolio credit risk is dependent on which borrowers default and how these defaults occur. The Bank considers a range of factors affecting portfolio risk. These include the creditworthiness of each borrower based on the Bank's internal credit ratings, exposure amount, losses arising from default and the level of correlation among borrowers (such as parent-subsidiary relationships within corporate groups as well as same-industry and different-industry relationships). In light of these analyses, the Bank uses a Monte Carlo Simulation to calculate potential portfolio losses (risk amount). The Bank then constructs a histogram of losses from a portfolio over a specified time horizon based on the assumed probability of default for each credit rating level. The average value of such a histogram represents the expected loss from the portfolio. Using a certain confidence interval, the Bank can also estimate the maximum loss amount that could occur. The difference between the maximum loss amount and the expected loss amount is defined as the volume of credit risk. The volume of credit risk is managed so as to ensure that it remains within the limits of allocated capital.

Market Risk Management

Market risk refers to the potential for losses due to fluctuations in the value of the Bank's assets and liabilities brought about by changes in such market variables as interest rates, stock prices or exchange rates. Market risk is not limited to financial instruments, such as marketable securities, whose value is directly affected by market fluctuations. All assets and liabilities, including deposits and loans, are subject to market risk.

Aozora Bank performs an analysis of the market risk affecting all assets and liabilities in order to control market risk appropriately throughout the Bank. As a financial institution classified as a global dealer, the Bank has developed a risk management system capable of addressing all aspects of market risk.

Market Risk Management System

Within the framework of integrated risk management, the Board of Directors decides the capital allocation for the entire Bank and for each business unit commensurate with market risk exposure. Market risk limits and loss limits are set in accordance with the capital allocation, and these unit limits are further subdivided into specific limits for each business division and section.

The Risk Management Division, which is independent of the so-called front-office divisions, centrally monitors the usage of, and compliance with, risk limits and stop-loss rules, and reports directly to the Board of Directors and the Executive Committee.

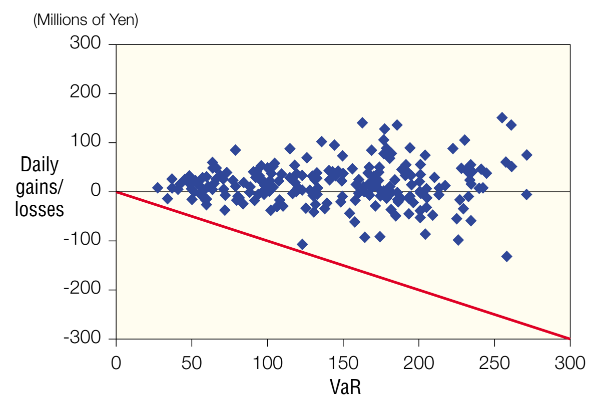
Quantifying Market Risk

Aozora Bank uses Value-at-Risk (VaR) to quantify market risk and as a basis for setting market risk limits. VaR is a statistical measure of estimated maximum losses that could arise based on historical market data. VaR serves as a common standard of measurement that estimates potential losses that could arise as a result of interest rate, stock price and exchange rate fluctuations.

Backtesting

The Bank conducts backtesting to verify the reliability of VaR calculations by comparing daily reported VaR with actual daily gains or losses. The results of the backtesting for trading activities show that the actual daily losses did not exceed daily VaR on any of the 246 business days during the period from April 1, 2002, through March 31, 2003. These results support the reliability of the Bank's VaR model.

Backtesting for Trading Activities
(April 2002–March 2003)



Stress Testing

The Bank regularly conducts stress tests to prepare for volatile market movements that could exceed statistical estimates. The Bank calculates and analyzes potential losses that could arise from dramatic changes in interest rates, stock prices and exchange rates, or from a collapse of correlations between different risk categories.

Stress Test Scenarios and Results

(Billions of Yen)

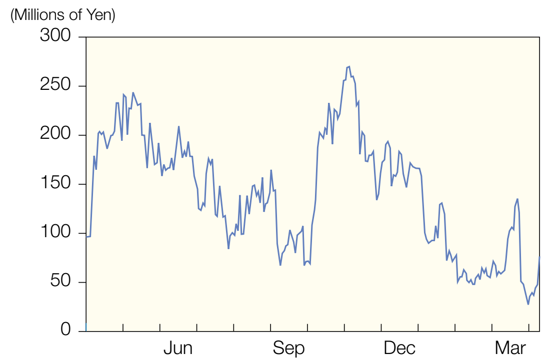
(March 31, 2003)		Result
Scenario 1	<Interest Rate Scenario> Uses the maximum change in interest rates*, assuming a holding period through to closing of positions (32 days for banking operations/10 days for trading activities) (a combination of maximum changes at each grid point).	30.1
Scenario 2	<Correlation Scenario> Uses the combination of statistical correlations among risk factors that had the greatest impact on the Bank's position, using correlation coefficients observed over the past 10 years.	1.3
Scenario 3	<Historical Market Volatility Scenario> Based on the historical simulation method, the daily market volatility rates for each trading day over the past nine years are applied to the position for the day being tested.	9.1
	Normal VaR	0.9
	Capital	493.4

Note: In addition to these scenarios, the Bank regularly conducts stress testing using a variety of other scenarios. Regarding data for prior years, the Bank uses interest rates over a period of approximately 10 years.

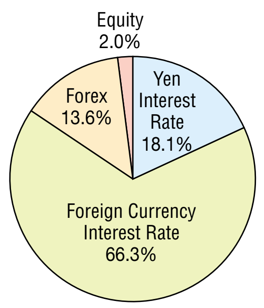
Trading Activities and Market Risk

In the fiscal year ended March 31, 2003, the market risk level of trading activities for a VaR model with a one-day holding period and a one-sided confidence interval of 99% was a maximum of ¥271 million, a minimum of ¥27 million and an average of ¥142 million.

VaR for Trading Activities
(April 2002–March 2003)



Breakdown of Risks Associated with Trading Activities
(As of March 31, 2003)



Asset–Liability Management (ALM) and Market Risk

The Treasury Division, which is responsible for ALM operations, centrally manages interest rate risk associated with all banking operations, excluding market activities, and market risks associated with securities, funds and derivatives held for ALM purposes. The Board of Directors approves capital allocation and risk limits with respect to ALM operations and the Executive Committee approves monthly management policy.

In the fiscal year ended March 31, 2003, the ALM risk level for a VaR model with a one-day holding period and a one-sided confidence interval of 99% was a maximum of ¥2.7 billion, a minimum of ¥0.6 billion and an average of ¥1.6 billion (weekly basis). The following diagrams show the weekly risk level during the fiscal year ended March 31, 2003, and the breakdown by risk category as of March 31, 2003.

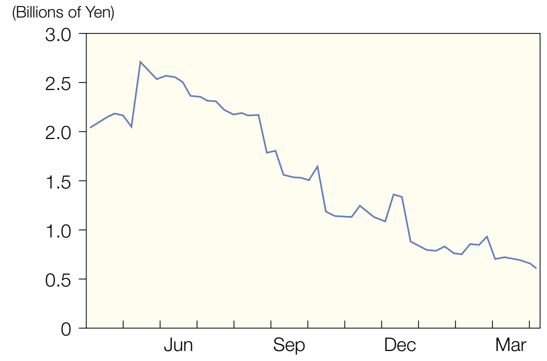
Interest Rate Sensitivity of Yen-Denominated Assets and Liabilities

(Billions of Yen)

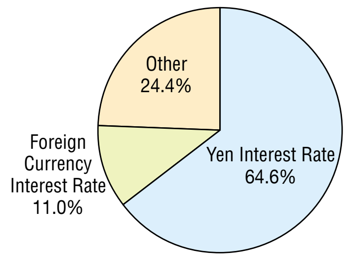
	One year or less	One to five years	More than five years	Total
March 31, 2003	(0.2)	(1.7)	(0.5)	(2.4)
March 31, 2002	0.5	(3.2)	(1.0)	(3.7)

Note: 10 bpv: For a 10bp (0.1%) increase in interest rates, a positive change in the fair value of assets and liabilities suggests that when the interest rate rises, fair value will increase. A negative change in fair value suggests that when interest rates decline, fair value will increase. Off-balance-sheet transactions are included.

VaR for ALM Operations
(April 2002–March 2003)



Breakdown of Risks Associated with ALM Operations
(As of March 31, 2003)



Market Risk Management for Other Operations

The Bank manages market risks associated with other operations, including cross-holding shares, as part of its risk management framework. Actions include setting limits and taking other steps to mitigate market risk.

VaR for the Entire Bank

(Billions of Yen)

March 31, 2003	Interest rate	Equity	Forex	Total
Trading	0.1	0.0	0.0	0.1
ALM	0.5	0.2	0.0	0.6
Others	—	0.3	—	0.3
Total	0.5	0.5	0.0	0.9

Note: The figures for total VaR do not represent the sum of individual components, as the latter includes correlations.

Liquidity Risk Management

There are two types of liquidity risk: funding liquidity risk, which is the risk that the Bank becomes unable to raise the funds necessary for various fund settlements; and market liquidity risk, which is the risk that the Bank becomes unable to unwind trading positions at reasonable market prices due to a number of factors, including market turmoil.

Funding Liquidity Risk Management

The Treasury Planning Division centrally manages yen and foreign-currency denominated funds and puts limits on funding gaps for specific periods. The division ensures that the Bank's funding capabilities are sufficient to meet its contractual obligations. At the same time, the Risk Management Division ensures that the management process is appropriate and effective through the maintenance of adequate checks and balances. The Board of Directors and other management bodies prepare monthly and semiannual plans for the investment and procurement of funds. The Treasury Planning Division reports directly to the Bank's senior management on liquidity issues, on a daily basis.

Market Liquidity Risk Management

The Risk Management Division analyzes trading positions relative to market size and reports to the Bank's senior management on market liquidity risk. Close attention is paid to ensuring that trading positions do not become excessive.

Operational Risk Management

Operational risk is defined as the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. Operational risks include administrative risk, systems risk and legal risk.

Operational risks harbor the potential for inconveniencing customers and causing significant losses, so the Bank has taken a variety of steps to mitigate operational risks at every point of potential risk. The Bank is also working on measures to upgrade administrative methodologies to expand the scope of statistical data on loss events and for centralized control in line with the New Basel Capital Accord.

Administrative Risk Management

Administrative risk refers to potential losses resulting from the failure of directors and employees to handle clerical work accurately as well as from accidents and irregularities.

Aozora Bank has established an administrative risk management policy that is carried out by the Operations Planning Division, which is independent from the Bank's business divisions and branches.

The Operations Planning Division formulates administrative procedures and manuals tailored to each business operation, with the aim of enhancing the reliability of clerical procedures. The division is also tasked with building an effective administration system by providing guidance on specific processes and holding training seminars, in addition to analyzing the volume of clerical work and reviewing organizational arrangements. The Bank aims to minimize human error arising from administrative processes by continuously reviewing and implementing greater automation, systemization and centralization of clerical procedures.

The Bank continues to explore ways to quantify clerical risks so as to further refine its risk management system.

Systems Risk Management

Systems risk is defined as the potential losses resulting from the failure of computer systems due to internal or external factors, including system crashes, system errors, unauthorized use of computer systems and computer viruses. With the advance in networking and diversification of banking operations, the consequences of systems failures for society at large are becoming increasingly serious.

Aozora Bank is making concerted efforts to control systems risk. To this end, the Board of Directors has approved the Systems Risk Management Policy. The Systems Planning Division is making every effort to protect systems from natural disasters and other contingencies to ensure their stable operation. The Bank has also taken various steps to protect computer systems from a wide range of disasters and criminal activities to reduce systems risk.

Systems development (Systems Planning Division) and systems operation (Computer Operation Division) have been clearly separated to ensure adequate checks and balances between the two divisions.

The Bank will introduce a new accounting system from the fiscal year ending March 31, 2005, which will include the use of outsourcing to reduce systems-related costs and the establishment of a backup center, to ensure a reliable and stable system.

Legal Risk Management

Legal risk is defined as potential losses resulting from lawsuits filed against the Bank by customers or other third parties for damage indemnification as well as other legal conflicts that could arise in the course of conducting a wide range of banking operations. Legal risk also includes unforeseeable losses arising from legal, yet inappropriate activities that result in a breach of trust between the Bank and its customers, as well as inappropriate contracts that require the Bank to assume obligations that would be dispensable under normal circumstances.

At Aozora Bank, the Compliance Management Division supervises legal affairs and compliance to prevent the possible occurrence of unforeseeable losses. At the same time, this division checks important documentation, such as major contracts, and confirms that all operations comply with relevant laws and regulations to ensure that all operations are being conducted properly.

Settlement Risk Management

Settlement risk management refers to potential losses arising from the failure to finalize settlements as planned. Settlement risk comprises a wide range of risks, such as credit and liquidity risk, administrative risk and systems risk.

A major component of settlement risk is the timing differences that arise between the payment and receipt of funds, and the payment and delivery of securities. This type of risk is not limited to foreign exchange transactions, which arises from the timing of settlements across international time zones, but also occurs within domestic transactions in a variety of contexts.

The Bank has set limits on settlement volumes for foreign exchange transactions by each customer, and adopted a policy of reducing settlement volumes by using netting techniques. The Bank is also working to shorten time intervals between the payment and receipt of funds.

Before participating in various settlement systems, the Bank makes sure it thoroughly understands the relevant rules of settlement systems. At the same time, the Bank monitors actual settlement situations in real time in accordance with changes to Real-Time Gross Settlement (RTGS) of the Bank of Japan Financial Network System (BOJ-NET). The Bank is also upgrading its settlement risk management systems by carefully studying the inherent risks of individual financial products and settlement systems.

Information Security Management

Information assets are just as important for a financial institution as tangible assets. However, information assets are vulnerable to a wide range of risks, such as accidents, disasters, systems errors, unauthorized use, damage, theft, information leakage and data manipulation. Therefore, protecting information assets by such measures as information leakage prevention is critical to the fulfilment of the Bank's confidentiality obligations to its customers and the safeguarding of the entire organization.

Guided by its Security Policy, Aozora Bank, including its consolidated subsidiaries, assesses the exposure of its information assets to various risks and monitors the countermeasures used to mitigate these risks to ensure the security of information systems.

The Bank's executive officer responsible for the Compliance Management Division acts as the Information Assets Supervisor, taking all necessary measures to ensure that the Bank's information assets are secure, and reports on asset security to the Board of Directors.

In addition, the Bank's main headquarters-based divisions, in line with their role of managing information assets, develop security plans and provide guidance to officers responsible for information assets, assigned to individual divisions, departments and branches, and resolve problems when they arise. The Compliance Management Division assists the officers responsible for information assets, thus ensuring strict implementation of the control system.

Internal Audit

At Aozora Bank, the Internal Audit Division, an autonomous body, assesses whether the Bank's risk management systems are functioning adequately and effectively. In this way, the Bank maintains an appropriate system of checks and balances to ensure sound and appropriate banking operations.

Compliance System

The Bank has established internal systems and rules that ensure due compliance with legal requirements and integrity in the conduct of all its operations, striving to foster a corporate culture that places priority on the achievement of these objectives.

Master Policy on Compliance

The Bank has instituted its *Master Policy on Compliance,* which sets forth the internal systems and basic principles needed to maintain compliance with all legal regulations in all aspects of its operations. In addition, the *Compliance Program*, which is updated annually, specifies action guidelines and compliance standards. The *Compliance Manual,* which contains specific codes of behavior, is distributed to all directors and employees, and steps are taken to ensure all recipients are familiar with the content of the manual. For the fiscal period ending March 31, 2004, the Bank plans to strengthen its training and educational programs as well as enhance the effectiveness of its periodic compliance audits to ensure that a culture of compliance with all laws and regulations takes firm root within the organization.

Compliance Organization and System

Primary responsibility for supervising legal and compliance issues at the Bank rests with the Compliance Management Division, which is involved in developing and improving compliance systems and conducting compliance checks that focus on various relevant legal issues. An executive officer of the Bank is appointed as Chief Compliance Officer (CCO) and the general manager of the Compliance Management Division supports the CCO as Executive Compliance Officer. The division provides internal legal consulting services, including the review and authorization of contracts, and is also responsible for formulating, monitoring and revising internal regulations.

Compliance leaders are appointed within all divisions and branches. Their duties include providing consultation services, carrying out compliance audits and promoting awareness of compliance-related issues. An independent Compliance Officer, directly responsible for ensuring that compliance procedures are adequately adhered to, is appointed within divisions where compliance is considered to be particularly important.

As part of the program to build a fair and honest corporate culture, the Bank has taken two major initiatives. These were (1) the introduction of a system allowing employees to consult directly with the Bank's legal advisers and auditors; and (2) the setting up of a system that enables the Compliance Management Division to independently communicate with employees on compliance issues. To maintain and enhance the corporate identity across the entire Aozora Bank Group, the Bank is working to develop an integrated compliance system covering all its affiliates through such measures as the establishment of an information sharing system on compliance issues.

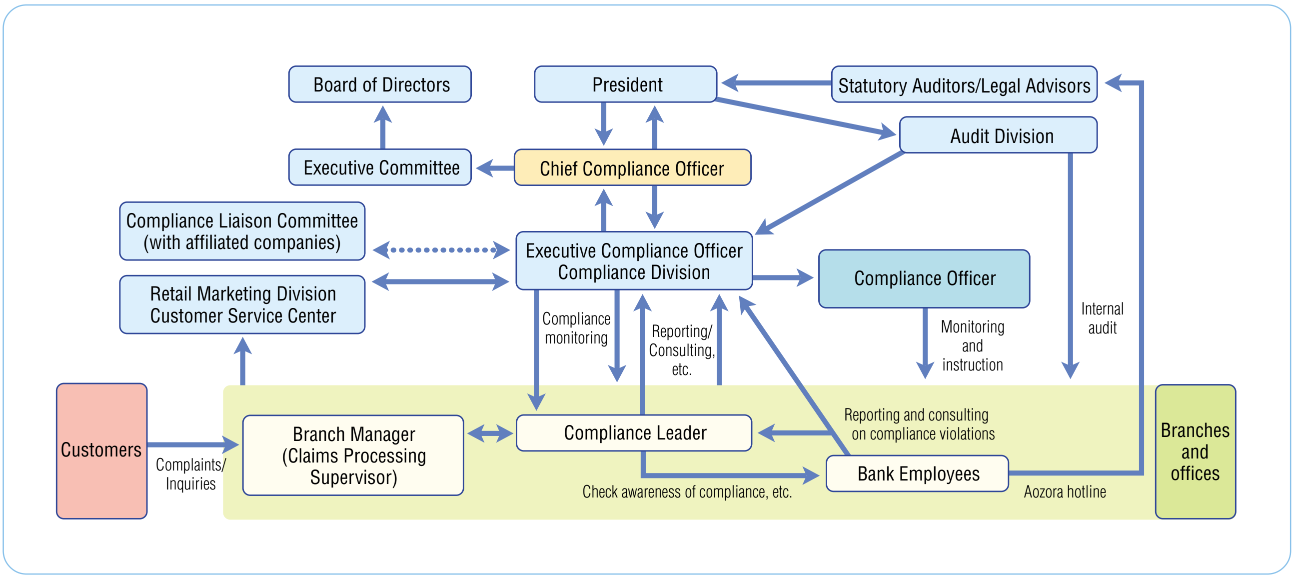
Compliance Training and Awareness Programs

Training programs for compliance leaders, which make use of outside lecturers, are conducted annually to ensure a thorough understanding of key compliance issues. After completing each program, compliance leaders then conduct staff training within their respective departments, divisions and branches. In this way, all directors and employees throughout the Bank gain a thorough understanding of current compliance issues.

The Bank has a wide variety of compliance training opportunities that it makes available to new employees and newly appointed department heads, as well as a variety of training programs that promote greater awareness of the importance of compliance throughout the Bank.

The Bank will continue to strengthen and expand the scope of its compliance systems among both management and employees.

Compliance System



New Headquarters

The Bank moved to a new headquarters building in March 2003, with the objective of introducing a fresh corporate image and raising operational efficiency. Not wishing to inconvenience our customers, we moved to a location in the Kudanshita district of central Tokyo, near to our previous headquarters. In addition, to enhance customer convenience and reduce costs, in May 2001 we embarked on a reorganization of our local branch network.

To commemorate the move to our new headquarters, we organized a series of special events. These included lectures by Mr. Yoshihiko Miyauchi (chairman and CEO of ORIX Corporation), Professor Hajime Karatsu (of Tokai University) and Mr. Kenichi Horie (solo yachtsman and explorer); concerts featuring harp and guitar recitals; a charity bazaar; and an art festival. These events were all successful in raising the Bank's profile.

New Human Resources System

To raise the value of the Bank—by continuing to develop new businesses and contributing to the prosperity of our stakeholders—we are striving for innovation in our human resources management.

In April 2002, as part of this strategy, we introduced a new personnel evaluation system. For each job function, we assign a grade according to its level of difficulty, then use that as a basis for a system of performance evaluation, thereby enabling us to pursue fairness and transparency.

In July 2003, we scrapped our existing human resources system and introduced a new performance-graded remuneration system. Under this new system, a Bank employee's grade is determined on the basis of their job performance, with the appropriate salary scale for that grade then being applied.

In the fiscal period under review, we also introduced the Challenge Program, under which employees can apply for reassignment within the Bank. This system aims to encourage greater specialization, as well as achieve a better fit between staff and their assigned jobs and more effective operations.

Contribution to Society

As part of the Bank's efforts to make a positive contribution to society, from July 2002 we began supporting the activities of the United Nations Human Settlements Programme (UN-Habitat), which promotes socially and environmentally sustainable towns and cities around the world. In particular, in the year under review, activities we supported particularly focused on reconstruction work in Afghanistan. The Bank supported this work through various programs, including giving away AOZORA elephant-shaped money boxes to assist in donation collection, as well as participating in the Sapporo Snow Festival, the Hiroshima Flower Festival and other events.

In April 2003, at our new headquarters, we held a charity lecture by UN-Habitat goodwill ambassador Ms. Mari Christine. In addition, we placed donation boxes at all of the Bank's branches.

FINANCIAL INFORMATION AND CORPORATE DATA

Consolidated Financial Highlights [Five-Year Summary]

Years Ended March 31

(Millions of Yen)

	2003	2002	2001	2000	1999
Operating income	109,748	106,700	275,730	223,909	455,333
Ordinary profit (loss)	8,920	14,355	99,116	(112,592)	(3,523,986)
Net income (loss)	23,376	18,703	98,331	112	(469,252)
Capital stock	419,781	419,781	419,781	353,114	353,114
Total stockholders' equity	497,514	477,046	460,876	1,229	1,503
Total assets	5,885,642	5,684,072	6,163,766	8,346,327	13,776,868
Debentures	1,470,126	1,468,193	2,479,408	3,709,377	4,347,380
Deposits	2,537,175	2,164,641	1,771,373	2,620,980	2,541,807
Loans and bills discounted	3,258,693	3,297,993	3,089,490	4,102,509	6,889,652
Securities	1,350,036	1,054,019	721,477	1,073,210	1,190,262
Total stockholders' equity per share (in yen)	75.29	68.07	62.36	0.39	0.48
Basic net income (loss) per share (in yen)	7.02	5.37	35.80	0.04	(187.58)
Diluted net income per share (in yen)	5.52	4.95	29.40	0.03	—
Consolidated capital adequacy ratio (domestic standard) (%)	13.30	14.05	15.13	—	—
Net cash provided by (used in) operating activities	105,182	923,515	(1,116,186)	453,607	
Net cash provided by (used in) investing activities	(347,870)	(376,664)	459,986	(30,168)	
Net cash provided by (used in) financing activities	(24,261)	(20,803)	235,036	(28,309)	
Cash and cash equivalents, end of year	290,872	557,822	31,774	453,037	

Notes: 1. Up to and including the fiscal year ended March 31, 2002, total stockholders' equity per share was calculated by dividing total stockholder's equity at the fiscal year-end, less the product of the number of preferred shares issued and outstanding at the fiscal year-end and the issue price, by the number of common shares issued and outstanding at the fiscal year-end, excluding treasury stock and parent company shares held by consolidated subsidiaries. However, since total stockholders' equity in the Bank was nil (¥0) for the fiscal years ended March 31, 1999, and 2000, total stockholders' equity per share for those years is calculated by dividing total stockholders' equity at the fiscal year-end by the number of shares issued and outstanding at the fiscal year-end, excluding treasury stock and parent company shares held by consolidated subsidiaries.

2. Up to and including the fiscal year ended March 31, 2002, net income (loss) per share was calculated by dividing consolidated net income (loss), less total dividends on preferred shares for the fiscal year ended March 31, 2002, by the average number of common shares issued and outstanding during the fiscal year ended March 31, 2002, excluding treasury stock and parent company shares and parent company shares held by consolidated subsidiaries.

3. From the fiscal year ended March 31, 2003, total stockholders' equity per share, net income (loss) per share and diluted net income per share are calculated by applying Financial Accounting Standard No. 2, "Accounting Standard for Earnings per Share" and Financial Accounting Standards Implementation Guidance No. 4, "Implementation Guidance for Accounting Standard for Earnings per Share."

4. Diluted net income per share is not given for the fiscal year ended March 31, 1999, as the Bank recorded a net loss for that period.

Consolidated Financial Review

1. Consolidation and Equity-Method Companies

The consolidated financial statements as of March 31, 2003, include the accounts of the Bank and its nine consolidated subsidiaries. During the fiscal year under review, one consolidated subsidiary was excluded owing to its liquidation. No companies were accounted for using the equity method.

Consolidation and Equity-Method Companies

March 31

(Number of Companies)

	2003	2002	Change
Consolidated subsidiaries	9	10	(1)
Affiliated companies	0	0	0

2. Income Analysis

For the fiscal year ended March 31, 2003, net income climbed 25.0%, to ¥23.4 billion. In addition to steady net interest income, net fees and commissions and net trading revenues recorded strong growth. Owing to an improvement in overall asset quality, credit-related expenses included a large reversal in general loan-loss reserve of ¥17.3 billion, leading to a surplus in the account for credit-related expenses of ¥16.5 billion. The consolidated capital adequacy ratio (domestic standard) remained high, at 13.30%.

Income Analysis

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Consolidated gross business profit (Note 1)	**76,828**	**66,926**	**9,902**
Net interest income	59,575	59,505	70
Net fees and commissions	7,388	5,210	2,178
Net trading revenues	3,446	537	2,909
Net other operating income	6,416	1,672	4,744
General and administrative expenses	**(42,565)**	**(39,579)**	**(2,985)**
Credit-related expenses (Note 2)	**(16,549)**	**(6,684)**	**(9,865)**
Gain and loss on stock transactions and loss on write-down of equity securities	**(1,079)**	**(995)**	**(84)**
Equity in earnings (losses) of affiliated companies . .	**—**	**(48)**	**48**
Other income (loss)	**(7,712)**	**(5,263)**	**(2,449)**
Ordinary profit	**8,920**	**14,355**	**(5,434)**
Special income (loss) (Note 2)	**11,690**	**3,794**	**7,895**
Income before income taxes and minority interests . .	**20,610**	**18,150**	**2,460**
Current income taxes	**(891)**	**(696)**	**(194)**
Deferred income taxes	**3,592**	**1,372**	**2,219**
Minority interests in net income	**64**	**(122)**	**187**
Net income	**23,376**	**18,703**	**4,673**
Total credit-related expenses (Note 2)	**1,157**	**(3,027)**	**4,185**
Reduction in loan-loss reserve included in special income . . .	17,344	3,656	13,687

Notes: 1. Consolidated gross business profit = (Interest income – Interest expenses) + (Fees and commissions (income) – Fees and commissions (expenses)) + (Trading profits – Trading losses) + (Other operating income – Other operating expenses)

2. For the fiscal year ended March 31, 2003, total credit-related expenses included special income items that were the result of a reversal of the general loan-loss reserve and a reversal in the reserve for credit losses on off-balance-sheet instruments. For the fiscal year ended March 31, 2002, total credit-related expenses included a special income item that was the result of a reversal of the general loan-loss reserve.

(1) Consolidated gross business profit

Despite falling interest rates leading to lower yields from investments in marketable securities, net interest income amounted to ¥59.6 billion, a similar level to the previous fiscal year. This result was mainly attributable to an improvement in the interest rate spread between deposits and loans owing to the Bank obtaining appropriate lending margins and reduced rates for fund procurement. Net fees and commissions increased ¥2.2 billion, to ¥7.4 billion, reflecting a strong performance in such operations as syndicated loans and committed lines of credit. Net trading revenues, which are mainly derived from market-related operations, jumped ¥2.9 billion, to ¥3.4 billion. Net other operating income rose ¥4.7 billion, to ¥6.4 billion, which was partly attributable to a strong result from our servicer subsidiary, AOZORA Loan Services Co., Ltd. As a result, consolidated gross business profit grew ¥9.9 billion, to ¥76.8 billion.

Consolidated Gross Business Profit

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Net interest income	**59,575**	**59,505**	**70**
Interest income	84,172	88,956	(4,783)
Interest expenses	24,596	29,450	(4,853)
Net fees and commissions	**7,388**	**5,210**	**2,178**
Fees and commissions (income)	8,123	5,777	2,345
Fees and commissions (expenses)	734	567	167
Net trading revenues	**3,446**	**537**	**2,909**
Trading profits	3,446	1,266	2,180
Trading losses	—	728	(728)
Net other operating income	**6,416**	**1,672**	**4,744**
Other operating income	9,630	5,225	4,404
Other operating expenses	3,213	3,553	339
Consolidated gross business profit	**76,828**	**66,926**	**9,902**

Notes: 1. Interest expenses excludes interest paid on money held in trust, which was nil (¥0) for the fiscal years ended March 31, 2002, and March 31, 2003. Fees and commissions (expenses) excludes bond redemption fees, which were ¥2 million in the fiscal year ended March 31, 2002, and ¥2 million in the fiscal year ended March 31, 2003.
2. For further details on net interest income, net fees and commissions, net trading revenues and net other operating income, please refer to page 66.

(2) General and administrative expenses

General and administrative expenses rose ¥3.0 billion, to ¥42.6 billion. Although we kept tight control of rental and other costs, higher retirement benefit-related expenses led to an overall rise.

(3) Total credit-related expenses

The Bank made the appropriate loan-loss write-offs and reserve provisions necessary to ensure the soundness of its asset portfolio. At the same time, we made progress in removing problem loans from the balance sheet. Owing to an improvement in the quality of the Bank's assets, the general loan-loss reserve was pushed into surplus after a reversal of the reserve, which was posted as a special income item. Consequently, total credit-related expenses amounted to income of ¥1.2 billion.

(4) Gain and loss on stock transactions and loss on write-down of equity securities

Gain and loss on stock transactions and loss on write-down of equity securities amounted to ¥1.1 billion.

(5) Ordinary profit

Ordinary profit declined ¥5.4 billion, to ¥8.9 billion. This result was mainly attributable to the surplus from the reversal of general loan-loss reserve being posted as a special income item.

(6) Special income

Special income resulting from the reversal of general loan-loss reserve was ¥17.3 billion. Partially offsetting this was a non-recurring depreciation of the Computer Center of ¥7.1 billion. Consequently, special income totaled ¥11.7 billion for the period under review.

(7) Net income

Income before income taxes and minority interests grew ¥2.5 billion, to ¥20.6 billion. Current income taxes totaled ¥0.9 billion, deferred income taxes amounted to ¥3.6 billion and minority interests in net loss were ¥64 million. As a result, net income for the period under review amounted to ¥23.4 billion.

3. Assets and Liabilities

Assets and Liabilities

March 31

(Millions of Yen)

	2003	2002	Change
Assets	**5,885,642**	**5,684,072**	**201,570**
Loans and bills discounted	3,258,693	3,297,993	(39,300)
Securities	1,350,036	1,054,019	296,017
Trading assets	532,291	422,694	109,597
Other assets	124,360	281,039	(156,679)
Customers' liabilities for acceptances and guarantees	114,329	141,354	(27,025)
Liabilities	**5,387,447**	**5,206,182**	**181,264**
Debentures	1,470,126	1,468,193	1,933
Deposits	2,119,669	1,636,733	482,936
Certificates of deposit	417,506	527,908	(110,402)
Call money and bills sold	574,895	728,500	(153,604)
Other liabilities	298,798	479,924	(181,125)
Acceptances and guarantees	114,329	141,354	(27,025)
Minority interests	**681**	**843**	**(162)**
Stockholders' equity	**497,514**	**477,046**	**20,467**

(1) Assets

The accumulation of high-quality assets, in addition to our efforts to dispose of non-performing assets, led to an overall decline in loans and bills discounted of ¥39.3 billion, to ¥3,258.7 billion. Securities increased ¥296.0 billion, to ¥1,350.0 billion, mainly reflecting a rise in investments in Japanese government bonds. As a result, assets increased ¥201.6 billion, to ¥5,885.6 billion.

(2) Liabilities and minority interests

As one of the Bank's main financing methods, debentures were relatively steady, posting a slight increase of ¥1.9 billion, to ¥1,470.1 billion. Deposits climbed ¥482.9 billion, to ¥2,119.7 billion. This result reflected a rise in large-balance corporate time deposits as well as strong growth in our retail product Aozora Direct Time Deposit. Consequently, liabilities rose ¥181.3 billion, to ¥5,387.4 billion. Minority interests fell ¥162 million, to ¥681 million.

(3) Stockholders' equity

A significant increase in retained earnings resulted in an increase in stockholders' equity of ¥20.5 billion, to ¥497.5 billion.

4. Consolidated Capital Adequacy Ratio (Domestic Standard)

March 31

(Millions of Yen)

		2003	2002
Tier I	Capital	419,781	419,781
	Non-cumulative perpetual preferred stock	272,036	272,036
	Newly issued stock	—	—
	Capital reserve	—	33,333
	Consolidation surplus	—	19,819
	Capital surplus	33,333	—
	Retained earnings	39,585	—
	Minority interest in consolidated subsidiaries	681	843
	Preferred stock issued overseas	—	—
	Net unrealized losses on available-for-sale securities	—	(235)
	Paid-in amount on treasury stock	—	—
	Treasury stock	(0)	(0)
	Foreign currency translation adjustments	—	785
	Goodwill	—	—
	Amount equal to consolidation adjustments	—	—
	Total (A)	**493,381**	**474,327**
	Step-up preferred stock	—	—
Tier II	Forty-five percent of the difference between fair value and book value in respect of land	—	—
	General reserve for possible loan losses	24,630	23,006
	Subordinated debt	6,598	20,317
	Total	**31,228**	**43,323**
	Tier II capital qualifying as capital (B)	**31,228**	**43,323**
Items deducted	**(C)**	**146**	**135**
Capital	**(A) + (B) – (C) (D)**	**524,464**	**517,515**
Risk-weighted assets	Balance-sheet exposure	3,811,435	3,580,495
	Off-balance-sheet exposure	129,502	100,495
	Total (E)	**3,940,938**	**3,680,990**
Capital adequacy ratio (domestic standard)	$\frac{(D)}{(E)}$ **x 100**	**13.30%**	**14.05%**
Tier I ratio (domestic standard)	$\frac{(A)}{(E)}$ **x 100**	**12.51%**	**12.88%**

Notes: 1. The capital adequacy ratio is calculated using the formula stipulated in a Ministry of Finance Notification based on Article 14-2 of the Banking Law, which follows the provisions of Article 17 of the Long-Term Credit Bank Law. The Bank uses the domestic standard.
2. The amount given for Items deducted (C) is equivalent to the amount held at other financial institutions for their capital-raising purposes. This amount is not included in the consolidated financial statements.

Consolidated Balance Sheets

Aozora Bank, Ltd. and Consolidated Subsidiaries
March 31, 2003 and 2002

ASSETS	Millions of Yen 2003	Millions of Yen 2002	Thousands of U.S. Dollars (Note 1) 2003
Cash and cash equivalents (Note 3)	¥ 290,872	¥ 557,822	$ 2,419,908
Due from banks	80,220	47,499	667,391
Call loans and bills bought	27,744	78,611	230,817
Receivables under securities borrowing transactions	166,730		1,387,109
Commercial paper and other debt purchased	89,272	41,252	742,699
Trading account assets (Notes 4, 11 and 24)	532,291	422,694	4,428,383
Money held in trust			8
Securities (Notes 5 and 11)	1,350,036	1,054,019	11,231,582
Loans and bills discounted (Notes 6 and 11)	3,258,693	3,297,993	27,110,591
Foreign exchanges (Note 7)	2,956	9,440	24,600
Other assets (Notes 11 and 15)	124,360	281,039	1,034,610
Premises and equipment (Note 8)	33,218	34,208	276,356
Deferred charges	184	289	1,537
Customers' liabilities for acceptances and guarantees (Note 9)	114,329	141,354	951,158
Deferred tax assets (Note 22)	13,777	10,983	114,618
Reserve for possible loan losses (Note 10)	(199,045)	(293,138)	(1,655,953)
TOTAL	¥5,885,642	¥5,684,072	$48,965,414

LIABILITIES AND STOCKHOLDERS' EQUITY	Millions of Yen 2003	Millions of Yen 2002	Thousands of U.S. Dollars (Note 1) 2003
LIABILITIES:			
Debentures (Note 12)	¥1,470,126	¥1,468,193	$12,230,673
Deposits (Notes 11 and 13)	2,537,175	2,164,641	21,107,949
Call money and bills sold (Note 11)	574,895	728,500	4,782,826
Payables under repurchase agreements (Note 11)	204,797		1,703,807
Commercial paper	3,000		24,958
Trading account liabilities (Note 4)	140,642	162,318	1,170,074
Borrowed money (Notes 11 and 14)	23,610	44,310	196,423
Foreign exchanges (Note 7)	2	2	17
Other liabilities (Note 15)	300,360	479,924	2,498,850
Liability for employees' retirement benefits (Note 16)	17,901	15,970	148,928
Reserve for credit losses on off-balance-sheet instruments	604	966	5,027
Other reserves			2
Acceptances and guarantees (Note 9)	114,329	141,354	951,158
Total liabilities	5,387,447	5,206,182	44,820,692
MINORITY INTERESTS	681	843	5,668
STOCKHOLDERS' EQUITY:			
Capital stock (Note 17):			
Common stock	147,745	147,745	1,229,161
Preferred stock	272,036	272,036	2,263,195
Capital surplus (Note 17)	33,333	33,333	277,316
Retained earnings (Notes 17 and 26)	43,293	23,381	360,181
Unrealized gain (loss) on available-for-sale securities	1,106	(235)	9,201
Foreign currency translation adjustments		785	
Total stockholders' equity	497,514	477,046	4,139,054
TOTAL	¥5,885,642	¥5,684,072	$48,965,414

See notes to consolidated financial statements.

Consolidated Statements of Income

Aozora Bank, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2003 and 2002

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2003	2002	2003
INCOME:			
Interest on:			
Loans and discounts	¥ 64,989	¥ 69,438	$ 540,678
Securities	8,040	9,474	66,894
Deposits with banks	514	951	4,279
Other	10,628	9,090	88,421
Fees and commissions	8,123	5,777	67,582
Trading account profits	3,446	1,266	28,676
Other operating income (Note 18)	9,630	5,225	80,118
Other income (Note 19)	23,512	9,693	195,614
Total income	128,885	110,920	1,072,262
EXPENSES:			
Interest on:			
Debentures	12,613	18,531	104,942
Deposits	8,700	6,139	72,383
Borrowings and rediscounts	1,081	1,257	9,000
Commercial paper		11	
Other	2,200	3,511	18,308
Fees and commissions	734	567	6,111
Trading account losses		728	
Other operating expenses (Note 20)	3,213	3,553	26,734
General and administrative expenses	42,565	39,579	354,122
Other expenses (Note 21)	37,164	18,890	309,190
Total expenses	108,274	92,770	900,790
INCOME BEFORE INCOME TAXES AND MINORITY INTERESTS	20,610	18,150	171,472
INCOME TAXES (Note 22):			
Current	891	696	7,417
Deferred	(3,592)	(1,372)	(29,888)
Total income taxes	(2,701)	(675)	(22,471)
MINORITY INTERESTS IN NET INCOME (LOSS)	(64)	122	(540)
NET INCOME	¥ 23,376	¥ 18,703	$ 194,483

	Yen		U.S. Dollars
	2003	2002	2003
PER SHARE OF COMMON STOCK (Notes 2.r and 25):			
Basic net income	¥7.02	¥5.37	$0.05
Diluted net income	5.52	4.42	0.04
Cash dividends of the fourth preferred stock	5.00	5.00	0.04
Cash dividends of the fifth preferred stock	3.72	3.72	0.03

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity

Aozora Bank, Ltd. and Consolidated Subsidiaries

Years Ended March 31, 2003 and 2002

	Thousands		Millions of Yen					
	Outstanding Number of Shares							
	Common Stock	Preferred Stock	Common Stock	Preferred Stock	Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Available-for-sale Securities	Foreign Currency Translation Adjustments
BALANCE, APRIL 1, 2001	2,834,870	914,811	¥147,745	¥272,036	¥33,333	¥ 6,457		¥1,303
Exclusion of affiliated companies previously included in consolidated accounts						73		
Net income						18,703		
Cash dividends to preferred stock						(1,852)		
Net increase in unrealized gain on available-for-sale securities							¥ (235)	
Net decrease in foreign currency translation adjustments								(518)
BALANCE, MARCH 31, 2002	2,834,870	914,811	147,745	272,036	33,333	23,381	(235)	785
Net income						23,376		
Cash dividends to preferred stock						(3,464)		
Net decrease in unrealized loss on available-for-sale securities							1,341	
Net decrease in foreign currency translation adjustments								(785)
BALANCE, MARCH 31, 2003	2,834,870	914,811	¥147,745	¥272,036	¥33,333	¥43,293	¥1,106	

	Thousands of U.S. Dollars (Note 1)					
	Common Stock	Preferred Stock	Capital Surplus	Retained Earnings	Unrealized Gain (Loss) on Available-for-sale Securities	Foreign Currency Translation Adjustments
BALANCE, MARCH 31, 2002	$1,229,161	$2,263,195	$277,316	$194,522	$ (1,955)	$6,534
Net income				194,483		
Cash dividends to preferred stock				(28,824)		
Net decrease in unrealized loss on available-for-sale securities					11,156	
Net decrease in foreign currency translation adjustments						(6,534)
BALANCE, MARCH 31, 2003	$1,229,161	$2,263,195	$277,316	$360,181	$ 9,201	

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows

Aozora Bank, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2003 and 2002

	Millions of Yen		Thousands of U.S. Dollars (Note 1)
	2003	2002	2003
OPERATING ACTIVITIES:			
Income before income taxes and minority interests	¥ 20,610	¥ 18,150	$ 171,472
Adjustments for:			
Depreciation and amortization	8,622	1,541	71,734
Net loss from non-consolidated entities accounted for by the equity method		48	
Decrease in reserve for possible loan losses	(94,092)	(63,650)	(782,798)
Increase in liability for employees' retirement benefits	1,930	91	16,061
Net increase (decrease) in reserve for credit losses on off-balance-sheet instruments	(362)	249	(3,016)
Interest income	(84,172)	(88,956)	(700,272)
Interest expenses	24,596	29,450	204,633
Net losses (gains) on sales and maturities securities	(721)	825	(6,004)
Profit from money held in trust	(3)	(1)	(27)
Net exchange losses (gains)	7,652	(7,889)	63,664
Net losses on disposal of premises and equipment	303	261	2,521
Net decrease (increase) in trading account assets	(109,597)	143,099	(911,789)
Net decrease in trading account liabilities	(21,675)	(20,843)	(180,328)
Net decrease (increase) in loans and bills discounted	39,300	(207,942)	326,956
Net increase in deposits	372,534	393,153	3,099,287
Net increase (decrease) in debentures	1,933	(1,004,329)	16,082
Net increase in borrowed money (excluding subordinated)		11	
Net decrease (increase) in due from banks	(32,741)	587,832	(272,388)
Net decrease in call loans and bills bought	2,847	276,391	23,686
Net increase in receivables under securities borrowing transactions	(79,539)		(661,723)
Net increase in call money and bills sold	51,193	585,500	425,900
Net increase (decrease) in commercial paper	3,000	(10,000)	24,958
Net decrease (increase) in foreign exchanges (asset)	6,483	(7,751)	53,941
Net decrease in foreign exchanges (liability)			(4)
Interest received in cash	92,493	88,966	769,499
Interest paid in cash	(27,220)	(33,145)	(226,462)
Other—net	(77,393)	240,616	(643,866)
Sub-total	105,982	921,680	881,717
Payments of income taxes	(799)	1,834	(6,654)
Net cash provided by operating activities	105,182	923,515	875,063
INVESTING ACTIVITIES:			
Purchases of securities	(3,311,015)	(1,960,730)	(27,545,886)
Proceeds from sale and maturities of securities	933,454	1,149,114	7,765,842
Proceeds from redemption of securities	2,072,748	489,069	17,244,163
Increase in money held in trust	(109,968)	(114,042)	(914,876)
Decrease in money held in trust	74,282	60,217	617,993
Increase in premises and equipment	(7,676)	(1,684)	(63,868)
Proceeds from sale of premises and equipment	305	991	2,538
Proceeds from sale of subsidiaries stocks (affecting the scope of consolidation)		399	
Net cash used in investing activities	(347,870)	(376,664)	(2,894,094)
FINANCING ACTIVITIES:			
Repayments of subordinated debt	(20,700)	(11,250)	(172,213)
Payments for redemption of subordinated bonds		(7,995)	
Proceeds from issuance of subsidiaries' stocks paid by minority stockholders		400	
Dividends paid to preferred stock	(3,464)	(1,852)	(28,824)
Dividends paid to the minority stockholders	(97)	(105)	(809)
Net cash used in financing activities	(24,261)	(20,803)	(201,846)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(266,949)	526,047	(2,220,877)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	557,822	31,774	4,640,785
CASH AND CASH EQUIVALENTS, END OF YEAR	¥ 290,872	¥ 557,822	$ 2,419,908

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Aozora Bank, Ltd. and Consolidated Subsidiaries
Years Ended March 31, 2003 and 2002

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of Aozora Bank, Ltd. (the “Bank” or the “Parent Company”) and its consolidated subsidiaries have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles and practices generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards. The consolidated financial statements are not intended to present the financial position, results of operations and cash flows in accordance with accounting principles and practices generally accepted in countries and jurisdictions other than Japan.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, certain reclassifications have been made in the 2002 financial statements to conform to the classifications used in 2003.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Bank is incorporated and operates. Japanese yen figures less than a million yen are rounded down to the nearest million yen, except for per share data. As a result, the totals do not necessarily agree with the sum of the individual amounts. The translations of Japanese yen amounts into U.S. dollar amounts are included solely for the convenience of readers outside Japan and have been made at the rate of ¥120.20 to $1, the approximate rate of exchange at March 31, 2003. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. Summary of Significant Accounting Policies

a. Consolidation—The consolidated financial statements as of March 31, 2003 include the accounts of the Bank and its consolidated subsidiaries, including Aozora Trust Bank, Ltd., Aozora Loan Services Co., Ltd., Aozora Card Co., Ltd. and 6 other subsidiaries in 2003 (7 other subsidiaries in 2002) (together, the “Group”).

Under the control or influence concept, those companies in which the Bank, directly or indirectly, is able to exercise control over operations are fully consolidated, and those companies over which the Group has the ability to exercise significant influence are accounted for by the equity method.

The consolidated financial statements do not include the accounts of 7 subsidiaries in 2003 (8 subsidiaries in 2002), because the combined total assets, total income, net income and earned surplus would not have had a material effect on the consolidated financial statements.

Investments in the remaining 7 unconsolidated subsidiaries in 2003 (8 unconsolidated subsidiaries in 2002) and 3 affiliated companies in 2003 (1 affiliated company in 2002) are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

The excess of the cost of an acquisition over the fair value of the net assets of the acquired subsidiaries at the date of acquisition is charged to income when incurred. On the other hand, the fair value of the net assets of subsidiaries acquired over the cost of an acquisition is also charged to income as incurred.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized profit included in assets resulting from transactions within the Group is eliminated.

b. Cash and Cash Equivalents—Cash and cash equivalents consist of cash on hand and due from the Bank of Japan.

c. Trading Account Assets/Liabilities—Transactions for trading purposes (the purpose of seeking to capture gains arising from short-term changes in interest rates, currency exchange rates or market prices of securities and other market-related indices or arbitrage opportunities) are included in “Trading account assets” and “Trading account liabilities” on a trade date basis. Trading account assets and liabilities are stated at fair value.

Profits and losses on transactions for trading purposes are shown as “Trading account profits” and “Trading account losses” on a trade date basis.

d. Securities—All applicable securities are classified and accounted for, depending on management's intent, as follows: (1) trading securities which are held for the purpose of earning capital gains in the near term are stated at fair value, and the related unrealized gains and losses are included in earnings, (2) held-to-maturity debt securities which are expected to be held to maturity with the positive intent and ability to hold to maturity are stated at amortized cost and (3) available-for-sale securities which are not classified as either of the aforementioned securities are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of stockholders' equity.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method. For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income. Securities included in money held in trust on behalf of the Bank are stated at fair value, and the related unrealized gains and losses are included in earnings.

e. Securities Transactions with Repurchase and Resale Agreement—Until the fiscal year ended March 31, 2002, securities transactions with repurchase/resale agreements of the Bank were recorded as a purchase or sale transaction. Effective April 1, 2002, these transactions were recorded as cash lending/borrowing and recorded in "Receivables under resale agreements" or "Payables under repurchase agreements." The effect of this change was to decrease "Other liabilities" by ¥204,797 million ($1,703,809 thousand).

f. Derivatives and Hedging Activities—Derivatives for purposes other than trading are stated at fair value.

The Bank has adopted so-called "macro hedging," a strategy to employ derivative transactions and control interest rate risks arising from financial assets and liabilities, such as loans, debentures and deposits, etc. within a set range, with aims to reduce risk as a whole, applying the temporary treatment of "Treatment for Accounting and Auditing of Application of Accounting Standard for Financial Instruments in Banking Industry" (Industry Audit Committee Report No. 24 of the Japanese Institute of Certified Public Accountants). This strategy is a risk management method of the risk adjustment approach prescribed in "Temporary Treatment for Accounting and Auditing of Application of Accounting Standard for Financial Instruments in Banking Industry" (Industry Audit Committee Report No. 15 of the Japanese Institute of Certified Public Accountants). The Bank adopts this risk adjustment approach as the temporary accounting prescribed in the above Industry Audit Committee Report No. 15 of the Japanese Institute of Certified Public Accountants.

g. Premises and Equipment—Premises and equipment are stated at cost. Depreciation of premises and equipment of the Bank and its consolidated domestic subsidiaries is computed by the declining-balance method at rates based on the estimated useful lives of the assets, while the straight-line method is applied to buildings. The range of useful lives is principally 50 years for buildings and from 5 to 15 years for other premises and equipment.

The Bank has shortened the useful lives of the computer center (Fuchu-bekkan) to rationally estimated useful lives of respective assets as a result of the Bank's restructuring of the computer system (see Note 21).

h. Software—Costs of software developed or obtained for internal use are depreciated over the estimated useful lives of the software (principally 5 years).

i. Deferred Charges—The Bank's deferred charges are amortized as follows.

Discounts on discount debentures are amortized by the straight-line method over the terms of the debentures. Debenture issuance expenses are amortized by the straight-line method over the shorter of the terms of the debentures or the 3-year period stipulated in the Japanese Commercial Code (the "Code").

Stock issuance costs are charged to income as incurred.

j. Write-off of Loans and Reserve for Possible Loan Losses—Write-off of loans and reserve for possible loan losses of the Bank are accounted for as follows in accordance with internal write-off and reserve standards.

Loans to borrowers under legal proceedings, such as bankruptcy, and loans in similar conditions, are written off by the amount of loans exceeding the estimated realizable value of collateral and guarantees. The amount written off in the current fiscal year amounted to ¥13,322 million ($110,839 thousand) and ¥77,515 million for the years ended March 31, 2003 and 2002, respectively.

For loans to borrowers not yet bankrupt but likely to fall into bankruptcy, the necessary specific reserve amounts are provided for through an overall assessment of the borrowers' ability to pay, after subtracting from the loan balance the amount collectible on disposal of collateral or execution of guarantees. As to other loans, the Bank provides for a general reserve by applying the historical loan-loss ratio determined over a certain period. An allowance for loans to specific foreign borrowers is provided based on the amount of expected losses due to the political and economic situation of their respective countries.

The Bank has also taken into account the precondition of exercise of the cancellation right in determining the necessary reserve amount. Under the clause of "Warranty of Loan Related Assets" described in the Share Purchase Agreement (see Note 17), a precondition of exercise of the cancellation right is the existence of a defect and a 20% deterioration of assets in value.

All loans are subject to asset quality assessment conducted by the business-related divisions in accordance with the Self-Assessment Standards, and the results of the assessments are reviewed by the Asset Audit Division, which is independent from business-related divisions, before the reserve amount is finally determined.

As to general loans, consolidated subsidiaries provide for a necessary reserve by applying the historical loan-loss ratio. For doubtful loans, consolidated subsidiaries provide a specific reserve in the amount deemed irrecoverable based on the individual loan's assessment.

k. Liability for Employees' Retirement Benefits—The Group accounts for the liability for employees' retirement benefits based on the projected benefit obligations and plan assets at the balance sheet date. Prior service cost is amortized using the straight-line method. Net actuarial gain (loss) is amortized using the straight-line method commencing from the next fiscal year of incurrence.

l. Reserve for Credit Losses on Off-balance-sheet Instruments—Reserve for credit losses on off-balance-sheet instruments is provided for credit losses on commitments to extend loans and other off-balance-sheet financial instruments based on an estimated loss ratio determined by the same methodology which is used in determining the reserve for loan losses.

m. Other Reserves—Other reserves include the reserve for securities transaction liabilities.

The reserve for securities transaction liabilities is required to be provided under the Securities and Exchange Law of Japan.

n. Lease Transactions—All leases of the Bank and its domestic consolidated subsidiaries are accounted for as operating leases. Under Japanese accounting standards for leases, finance leases that deem to transfer ownership of the leased property to the lessee are to be capitalized, while other finance leases are permitted to be accounted for as operating lease transactions if certain "as if capitalized" information is disclosed in the notes to the consolidated financial statements.

o. Income Taxes—Deferred income taxes are recorded to reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred taxes are measured by applying currently enacted tax laws to the temporary differences.

p. Foreign Currency Items—Assets and liabilities denominated in foreign currencies held by the Bank at the year end are translated into Japanese yen at exchange rates prevailing at the end of fiscal year except equity securities of affiliated companies which are translated at historical rates.

Foreign currency assets and liabilities of other consolidated subsidiaries are principally translated into yen equivalents at the exchange rates prevailing at fiscal year end of each company.

In the fiscal year ended March 31, 2002, the Bank had adopted the Industry Audit Committee Report No. 20, "Temporary Treatment of Accounting and Auditing Concerning Accounting for Foreign Currency Transactions in the Banking Industry," issued by the Japanese Institute of Certified Public Accountants on November 14, 2000. In the fiscal year ended March 31, 2003, however, the Bank has adopted the Industry Audit Committee Report No. 25, "Treatment of Accounting and Auditing Concerning Accounting for Foreign Currency Transactions in the Banking Industry," issued by the Japanese Institute of Certified Public Accountants on July 29, 2002.

In the fiscal year ended March 31, 2003, as the Bank has adopted the transitional applications described in the Industry Audit Committee Report No. 25, "fund swap transactions," "currency swap transactions" and "treatment of internal contract method and intercompany transactions" are accounted for in the same method as before. The translation difference of forward exchange transactions and other relevant transactions are presented with the net balance of the related asset or liability.

For fund swap transactions, the Bank translates the principal equivalents of assets and liabilities using the exchange rates prevailing at fiscal year end. Differences between spot and forward rates in fund swap transactions are recorded in interest income or expense on an accrual basis for the period from the settlement date of spot foreign exchange to the settlement date of forward foreign exchange.

Fund swap transactions are foreign exchange swaps, and consist of spot foreign exchange either bought or sold and forward foreign exchange either sold or bought. Such transactions are contracted for the purpose of funds lending or borrowing in a different currency. Fund swap transactions are used to convert the principal equivalent amount into spot foreign exchange bought or sold with regard to the corresponding funds borrowing or lending. Also, such transactions convert the corresponding principal equivalents and foreign currency equivalents to pay and receive, whose amounts and due dates are predetermined at the time of the transactions, into forward foreign exchange either bought or sold.

For currency swap transactions which are for the purpose of funds borrowing/lending in different currencies and for which spot/forward are flat type, which means that paying or receiving amounts at the time of the currency swap contract are equal to receiving or paying amounts at the currency swap maturity dates and the swap rate applied to principal and interest is the current market rate (including the currency swap transactions which are that the principal amount of one counter party is revised in order to reflect each exchange rate at interest payment dates and are judged as spot/forward flat type for each interest payment date), the amounts on the balance sheet are net positions of financial asset and liability equivalents translated by using the exchange rates prevailing at fiscal year end. The equivalent amounts of interest to exchange are recorded in interest income or expense on an accrual basis for the corresponding contract period.

q. Dividends—Dividends are generally paid semiannually. Interim and year-end dividends are authorized subsequent to the end of the period to which they are related, and are reflected in the consolidated statements of stockholders' equity when duly declared and authorized.

No dividend was proposed for stockholders of common stock for the years ended March 31, 2003 and 2002.

r. Per Share Information—Effective April 1, 2002, the Bank adopted a new accounting standard for earnings per share of common stock issued by the Accounting Standards Board of Japan. Under the new standard, basic net income per share is computed by dividing net income available to common stockholders, which is more precisely computed than under previous practices, by the weighted-average number of common stock outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share reflects the potential dilution that could occur if securities were exercised or converted into common stock. Diluted net income per share of common stock assumes full conversion of the preferred stock at the beginning of the year with an applicable adjustment for related dividends to preferred stock. Basic net income and diluted net income per share for the years ended March 31, 2003 and 2002 are computed in accordance with the new standard.

Cash dividends per share presented in the accompanying consolidated statements of income are dividends applicable to the respective years including dividends to be paid after the end of the year.

3. Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Cash on hand	¥ 23,407	¥ 21,916	$ 194,735
Due from the Bank of Japan	267,465	535,906	2,225,173
Total	¥290,872	¥557,822	$2,419,908

4. Trading Account Assets and Liabilities

Trading account assets and liabilities at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Trading account assets:			
Trading securities	¥ 43,444	¥101,775	$ 361,434
Derivatives of trading securities	11	13	99
Derivatives of securities held to hedge trading transactions	9	50	75
Derivatives of trading transactions	140,538	142,782	1,169,207
Other	348,287	178,072	2,897,568
Total	¥532,291	¥422,694	$4,428,383
Trading account liabilities:			
Trading securities sold short		¥ 15,726	
Derivatives of trading securities	¥ 57	191	$ 474
Derivatives of securities held to hedge trading transactions		60	
Derivatives of trading transactions	140,585	146,340	1,169,600
Total	¥140,642	¥162,318	$1,170,074

5. Securities

Securities at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Japanese national government bonds	¥ 965,526	¥ 734,003	$ 8,032,667
Japanese local government bonds	70,987	6,649	590,580
Japanese corporate bonds	78,067	68,186	649,483
Japanese stocks	1,877	3,079	15,619
Other	233,576	242,099	1,943,233
Total	¥1,350,036	¥1,054,019	$11,231,582

The carrying amounts and aggregate fair values of securities at March 31, 2003, were as follows:

	Millions of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Market Value
Securities classified as:				
Available-for-sale:				
Japanese national government bonds	¥ 964,492	¥1,066	¥ 42	¥ 965,515
Japanese local government bonds	70,321	187	65	70,443
Japanese corporate bonds	46,975	506	1,031	46,450
Japanese stocks	242	6	1	247
Other*	93,100	1,615	335	94,380
Held-to-maturity—Japanese national government bonds	10			10
Total	¥1,175,143	¥3,381	¥1,476	¥1,177,048

	Thousands of U.S. Dollars			
	Cost	Unrealized Gains	Unrealized Losses	Market Value
Securities classified as:				
Available-for-sale:				
Japanese national government bonds	$8,024,060	$ 8,872	$ 357	$8,032,576
Japanese local government bonds	585,040	1,562	548	586,054
Japanese corporate bonds	390,815	4,212	8,583	386,444
Japanese stocks	2,019	51	11	2,059
Other*	774,543	13,438	2,787	785,194
Held-to-maturity—Japanese national government bonds	91			91
Total	$9,776,568	$28,135	$12,286	$9,792,417

The carrying amounts and aggregate fair values of securities at March 31, 2002, were as follows:

	Millions of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Market Value
Securities classified as:				
Available-for-sale:				
Japanese national government bonds	¥733,380	¥ 658	¥ 46	¥733,992
Japanese local government bonds	6,393	257	1	6,649
Japanese corporate bonds	44,535	290	1,708	43,117
Japanese stocks	451	28	7	472
Other*	78,603	1,320	1,025	78,898
Held-to-maturity—Japanese national government bonds	10			10
Total	¥863,375	¥2,555	¥2,789	¥863,141

Available-for-sale securities whose fair value is not readily determinable as of March 31, 2003 and 2002, were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Available-for-sale:			
Local government bonds	¥ 544		$ 4,526
Japanese corporate bonds	31,617	¥ 25,069	263,039
Japanese stocks	1,570	2,633	13,063
Other*	140,336	165,415	1,167,528
Total	¥174,068	¥193,117	$1,448,156

* The other assets which were reported at fair value, with unrealized gains and losses, net of applicable taxes, include investments in partnership and others.

Proceeds from sales of available-for-sale and gross realized gains and losses on these sales for the years ended March 31, 2003 and 2002, were as follows:

	Carrying Amount		
	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Proceeds from sales	¥934,223	¥1,507,846	$7,772,238
Gross realized gains	3,376	3,050	28,093
Gross realized losses	964	1,770	8,022

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale and held-to-maturity at March 31, 2003, were as follows:

	Millions of Yen		Thousands of U.S. Dollars	
March 31, 2003	Available for Sale	Held to Maturity	Available for Sale	Held to Maturity
Due in one year or less	¥ 663,953		$ 5,523,742	
Due after one year through five years	575,231	¥10	4,785,622	$91
Due after five years through ten years	56,739		472,043	
Due after ten years	31,253		260,014	
Total	¥1,327,178	¥10	$11,041,421	$91

The carrying values and valuation gain recognized in the consolidated statements of income of the trading securities classified as trading assets at March 31, 2003 and 2002, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Trading securities:			
Carrying value	¥391,732	¥279,848	$3,259,002
Valuation gain (loss) included in the income (loss) before income taxes	161	(110)	1,341

The above trading securities include negotiable certificates of deposits and commercial paper which were classified as trading assets.

6. Loans and Bills Discounted

Loans and bills discounted at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Bills discounted	¥ 5,524	¥ 4,669	$ 45,957
Loans on notes	635,342	915,147	5,285,711
Loans on deeds	2,440,107	2,211,280	20,300,394
Overdrafts	177,719	166,895	1,478,529
Total	¥3,258,693	¥3,297,993	$27,110,591

"Loans to bankrupt borrowers" are loans to borrowers who are legally bankrupt and amounted to ¥9,237 million ($76,854 thousand) and ¥18,270 million as of March 31, 2003 and 2002, "Past due loans" refers to non-accrual loans except for loans to bankrupt borrowers and loans to borrowers for which concessions on payments of interests were made in order to assist the reorganization of borrowers and amounted to ¥98,988 million ($823,530 thousand) and ¥313,555 million as of March 31, 2003 and 2002, respectively.

"Loans over due for three months or more" refers to those loans for which principal or interest remains unpaid at least for three months, excluding loans to bankrupt companies and past due loans and amounted to ¥1,340 million ($11,148 thousand) and ¥1,590 million as of March 31, 2003 and 2002, respectively.

"Restructured loans" refers to loans, excluding loans to bankrupt borrowers, past due and/or overdue for three months or more, for which agreement was made to provide reduction or moratorium of interest payments, or concessions in the borrower's favor on interest or principal payment or to waive claims for the purpose of assisting the reconstruction of insolvent borrowers and amounted to ¥90,206 million ($750,468 thousand) and ¥154,326 million as of March 31, 2003 and 2002, respectively.

The amounts referred to above are the amounts before bad debts are written off and specific reserves for possible loan losses are provided for.

Overdraft contracts and contracts for the commitment line for loans are those by which consolidated subsidiaries are bound to extend loans up to the prearranged amount, at the request of customers, unless the customer is in breach of contract conditions. The unutilized balance of these contracts amounts to ¥246,846 million ($2,053,630 thousand) and ¥261,028 million as of March 31, 2003 and 2002, respectively. ¥214,885 million ($1,787,729 thousand) and ¥250,694 million of these amounts relate to contracts of which original contractual terms are of a term of one year or less, or unconditionally cancelable at any time as of March 31, 2003 and 2002, respectively.

The amount of loans sold through senior certificate under a collateralized loan obligation (CLO) securitization totaled ¥50,000 million ($415,973 thousand) for the year ended March 31, 2003, with the subordinated certificate retained by the Bank totaling ¥17,200 million ($143,094 thousand) as of March 31, 2003, recorded as loans.

7. Foreign Exchanges

Foreign exchanges at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Assets:			
Foreign bills bought		¥ 100	
Due from foreign banks	¥2,956	9,339	$24,600
Total	¥2,956	¥9,440	$24,600
Liabilities—Due to foreign banks	¥ 2	¥ 2	$ 17
Total	¥ 2	¥ 2	$ 17

8. Premises and Equipment

Accumulated depreciation amounted to ¥25,401 million ($211,328 thousand) and ¥19,522 million at March 31, 2003 and 2002, respectively.

9. Customers' Liabilities for Acceptances and Guarantees

All contingent liabilities arising from acceptances and guarantees are reflected in acceptances and guarantees. As a contra account, customers' liabilities for acceptances and guarantees are shown as assets representing the Bank's right of indemnity from customers.

10. Reserve for Possible Loan Losses

Reserve for possible loan losses at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
General reserve	¥167,265	¥175,602	$1,391,557
Specific reserve	30,436	116,882	253,218
Reserve for loans to restructuring countries	1,343	653	11,178
Total	¥199,045	¥293,138	$1,655,953

11. Collateral

The carrying amounts of assets pledged as collateral and the collateralized debt at March 31, 2003 and 2002, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Securities	¥ 565,522	¥ 500,467	$4,704,847
Loans and bills discounted	225,043	313,402	1,872,243
Trading account assets	286,062		2,379,888
Other assets (securities in custody and other)		64,062	
Total	¥1,076,628	¥ 877,933	$8,956,978
Deposits	¥ 50,000		$ 415,973
Borrowed money	100		832
Call money and bills sold	464,900	¥ 611,700	3,867,720
Payables under repurchase agreements	204,797		1,703,807
Total	¥ 719,797	¥ 611,700	$5,988,332

In addition, the following assets were pledged or deposited as margin money with respect to foreign exchange settlements and derivatives at March 31, 2003 and 2002:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Securities	¥132,510	¥146,821	$1,102,420
Securities in custody and other		4,307	
Total	¥132,510	¥151,129	$1,102,420

12. Debentures

Debentures at March 31, 2003 and 2002, consisted of the following:

March 31, 2003	Millions of Yen	Thousands of U.S. Dollars	Interest Rates
One-year discount debentures	¥ 85,618	$ 712,296	0.04%–0.16%
One-year coupon debentures	712,200	5,925,125	0.10%–0.90%
Two-year coupon debentures	440,900	3,668,053	0.40%–1.10%
Three-year coupon debentures	84,250	700,915	0.55%–1.25%
Five-year coupon debentures	147,158	1,224,284	0.10%–2.95%
Total	¥1,470,126	$12,230,673	

March 31, 2002	Millions of Yen		Interest Rates
One-year discount debentures	¥ 159,240		0.06%–0.44%
One-year coupon debentures	408,300		0.10%–0.90%
Two-year coupon debentures	613,400		0.40%–1.30%
Three-year coupon debentures	84,050		0.55%–1.25%
Five-year coupon debentures	203,202		0.20%–3.05%
Total	¥1,468,193		

13. Deposits

Deposits at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Current deposits	¥ 112,326	¥ 114,337	$ 934,498
Ordinary deposits	438,819	434,835	3,650,745
Deposits at notice	34,125	56,005	283,906
Time deposits	1,510,350	1,022,223	12,565,310
Negotiable certificates of deposit	417,506	527,908	3,473,427
Other	24,047	9,331	200,063
Total	¥2,537,175	¥2,164,641	$21,107,949

14. Borrowed Money

The weighted averaged annual interest rate applicable to the borrowed money was 2.25% and 2.83% at March 31, 2003 and 2002, respectively.

Borrowed money includes subordinated borrowings, which amounted to ¥23,495 million ($195,465 thousand) and ¥44,195 million at March 31, 2003 and 2002, respectively.

Annual maturities of borrowed money as of March 31, 2003, for the next five years and thereafter were as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2004		
2005	¥14,000	$116,473
2006	9,495	78,993
2007		
2008	100	832
2009 and thereafter	15	125
Total	¥23,610	$196,423

15. Other Assets and Liabilities

Other assets and liabilities at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Other assets:			
Accrued income	¥ 6,283	¥ 12,698	$ 52,279
Accounts receivables	12,566	4,567	104,542
Investments in partnership	40,562	23,004	337,462
Derivative financial instruments	27,461	20,642	228,468
Financial stabilization fund	32,628	32,628	271,448
Securities in custody and other		93,341	
Cash collateral on borrowed bonds		87,191	
Other	4,857	6,965	40,411
Total	¥124,360	¥281,039	$1,034,610
Other liabilities:			
Accounts payables:			
For trading account transactions	¥ 4,821	¥160,049	$ 40,111
Other	6,266	3,462	52,131
Accrued expenses	15,262	16,473	126,986
Collateral under securities lending transactions		114,887	
Borrowed securities		69,238	
Other	274,010	115,813	2,279,622
Total	¥300,360	¥479,924	$2,498,850

16. Liability for Employees' Retirement Benefits

The Bank has employees' retirement benefits plans. Such retirement benefits are made in the form of a lump-sum severance payment from the Bank and annuity payments from trustees.

The liability for employees' retirement benefits plans at March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Projected benefit obligation	¥ 40,100	¥ 40,389	$ 333,614
Fair value of plan assets	(15,770)	(17,650)	(131,202)
Unrecognized prior service cost	2,660	1,050	22,132
Unrecognized actuarial loss	(9,089)	(7,818)	(75,616)
Net liability	¥ 17,901	¥ 15,970	$ 148,928

The components of net periodic benefit costs of the employees' retirement benefits plans for the years ended March 31, 2003 and 2002, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Service cost	¥1,648	¥1,653	$13,715
Interest cost	947	1,115	7,885
Expected return on plan assets	(524)	(570)	(4,364)
Amortization of prior service cost	(88)	(14)	(738)
Recognized actuarial loss	1,619	260	13,474
Net periodic benefit costs	¥3,602	¥2,443	$29,972

Assumptions used for the years ended March 31, 2003 and 2002, are set forth as follows:

	2003	2002
Discount rate	2.4%	2.4%
Expected rate of return on plan assets:		
Approved retirement annuities	0.5%	2.3%
Fund of welfare pension	3.5%	3.5%
Amortization period of prior service cost	9–12 years as average remaining service period	12 years as average remaining service period
Recognition period of actuarial gain/loss	5 years or average remaining service period if less than 5 years	5 years or average remaining service period if less than 5 years

17. Stockholders' Equity

(1) Capital Stock and Capital Surplus

The authorized numbers of shares at March 31, 2003, were 5,189 million shares of common stock and 943 million shares of non-voting and non-cumulative preferred stock. The numbers of treasury stock at March 31, 2003, were 705 shares.

Japanese companies are subject to the Code to which certain amendments became effective from October 1, 2001.

The Code was revised whereby common stock par value was eliminated resulting in all shares being recorded with no par value and at least 50% of the issue price of new shares is required to be recorded as common stock and the remaining net proceeds as additional paid-in capital, which is included in capital surplus. The Code permits Japanese companies, upon approval of the Board of Directors, to issue shares to existing stockholders without consideration as a stock split. Such issuance of shares generally does not give rise to changes within the stockholders' accounts.

The Code permits to transfer portions of additional paid-in capital and legal reserve to stated capital by resolution of the Board of Directors. The Code also permits to transfer portions of unappropriated retained earnings, available for dividends, to stated capital by resolution of the stockholders.

The revised Code eliminated restrictions on the repurchase and use of treasury stock allowing Japanese companies to repurchase treasury stock by a resolution of the stockholders at the general stockholders meeting and dispose of such treasury stock by resolution of the Board of Directors beginning April 1, 2002. The repurchased amount of treasury stock cannot exceed the amount available for future dividend plus amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general stockholders meeting.

On June 29, 2000, the Bank used capital surplus to reduce the deficit in accordance with the resolution of the stockholders meeting.

On June 30, 2000, SOFTBANK CORP., ORIX Corporation, The Tokio Marine and Fire Insurance Co., Ltd. and other financial institutions (the "Consortium"), Deposit Insurance Corporation of Japan and the Bank signed the Share Purchase Agreement for the transfer of the Bank's stock (the "Share Purchase Agreement"). On September 1, 2000, the Consortium purchased the Bank's ordinary stock in accordance with the Share Purchase Agreement from Deposit Insurance Corporation of Japan, as a result, which terminated the Bank's special public management.

On September 2, 2000, the Bank issued 333,334 thousand stocks of common stock with a par value of ¥50 per share at the issue price of ¥300 per share to the Consortium.

On October 3, 2000, the Bank made a capital reduction by the retirement of 560,254 thousand preferred shares and a decrease in the stated value of common stock. This capital reduction was made without repayment to stockholders; therefore, the corresponding amount was transferred to capital surplus from capital stock in conformity with the Share Purchase Agreement and decisions of extraordinary stockholders meeting held on August 31, 2000 and on September 26, 2000.

On October 4, 2000, the Bank issued 866,667 thousand shares of preferred stock at the issue price of ¥300 per share to The Resolution and Collection Corporation in conformity with Financial Early Stabilization Law.

Preferred stock for the years ended March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Preferred stock—authorized, 76,144 thousand shares; issued and outstanding, 48,144 thousand shares of fourth preferred stock	¥ 12,036	¥ 12,036	$ 100,133
Preferred stock—authorized, 867,000 thousand shares; issued and outstanding, 866,667 thousand shares of fifth preferred stock	260,000	260,000	2,163,062
Total	¥272,036	¥272,036	$2,263,195

(2) Retained Earnings

Under the Bank Law of Japan, an amount equivalent to at least 20% of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 100% of the Bank's stated capital. A legal reserve amount is not available for dividends but may be used to reduce a deficit by resolution of the stockholders or may be capitalized by resolution of the Board of Directors.

The amount of retained earnings available for dividends under the Code was ¥42,639 million ($354,739 thousand) as of March 31, 2003, based on the amount recorded in the Parent Company's general books of account. In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends.

Dividends are approved by the stockholders at a meeting held subsequent to the fiscal year to which the dividends are applicable. Semiannual interim dividends may also be paid upon resolution of the Board of Directors, subject to certain limitations imposed by the Code.

18. Other Operating Income

Other operating income for the years ended March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Other operating income:			
Gain on sales of bonds	¥3,165	¥2,747	$26,332
Gain on redemption of bonds		115	
Other	6,465	2,361	53,786
Total	¥9,630	¥5,225	$80,118

19. Other Income

Other income for the years ended March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Gain on sales of stocks and other securities	¥ 211	¥ 616	$ 1,762
Other	23,301	9,077	193,852
Total	¥23,512	¥9,693	$195,614

20. Other Operating Expenses

Other operating expenses for the years ended March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Other operating expenses:			
Amortization of debenture issuance costs	¥ 279	¥ 272	$ 2,326
Loss on foreign exchange transactions		155	
Loss on sales of bonds	1,085	930	9,032
Loss on redemption of bonds	280	1,762	2,332
Loss on derivatives	1,182		9,842
Other	384	431	3,202
Total	¥3,213	¥3,553	$26,734

21. Other Expenses

Other expenses for the years ended March 31, 2003 and 2002, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Provision for reserve for credit losses on off-balance-sheet instruments		¥ 249	
Write-off of claims	¥11,939	4,796	$ 99,332
Loss on sales of stocks and other securities	648	962	5,392
Loss on write-down of stocks	643	649	5,354
Loss on disposal of premises and equipment	303	414	2,522
Accelerated depreciation	7,143		59,431
Other	16,486	11,817	137,159
Total	¥37,164	¥18,890	$309,190

22. Income Taxes

The Bank and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in normal effective statutory tax rates of approximately 41.9% and 41.7% for the years ended March 31, 2003 and 2002, respectively.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities at March 31, 2003 and 2002, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Deferred tax assets:			
Tax loss carryforwards	¥ 231,706	¥ 206,899	$ 1,927,675
Loss on devaluation of securities	935	919	7,783
Reserve for possible loan losses	82,254	155,269	684,316
Other	53,067	11,773	441,491
Less valuation allowance	(353,386)	(363,877)	(2,939,990)
Total	14,577	10,983	121,275
Deferred tax liabilities—Unrealized gain on available-for-sale securities	(800)		(6,657)
Net deferred tax assets	¥ 13,777	¥ 10,983	$ 114,618

A reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2003 and 2002, is as follows:

	2003	2002
Normal effective statutory tax rate	41.9%	41.7%
Expenses not deductible for income tax purposes	(0.2)	(0.7)
Valuation allowance	(53.1)	(45.5)
Other—net	(1.7)	0.8
Actual effective tax rate	(13.1)%	(3.7)%

At March 31, 2003, the Bank and a consolidated subsidiary have tax loss carryforwards which are available to be offset against taxable income in future years. These tax loss carryforwards, if not utilized, will expire as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2005	¥179,961	$1,497,183
2007	25,076	208,623
2008	26,668	221,869
Total	¥231,706	$1,927,675

23. Lease Transactions

The Bank and consolidated subsidiaries lease certain equipment and other assets.

Lease payments under finance leases were ¥1,141 million ($9,498 thousand) and ¥1,373 million for the years ended March 31, 2003 and 2002, respectively.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligation under finance lease, depreciation expense and interest expense of finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2003 and 2002, was as follows:

For the Year Ended March 31, 2003

	Millions of Yen			Thousands of U.S. Dollars		
	Equipment	Other	Total	Equipment	Other	Total
Acquisition cost	¥5,638	¥401	¥6,039	$46,906	$3,343	$50,249
Accumulated depreciation	3,241	111	3,353	26,970	930	27,900
Net leased property	¥2,396	¥290	¥2,686	$19,936	$2,413	$22,349

For the Year Ended March 31, 2002

	Millions of Yen		
	Equipment	Other	Total
Acquisition cost	¥5,175	¥401	¥5,577
Accumulated depreciation	2,747	31	2,779
Net leased property	¥2,427	¥370	¥2,798

Obligations under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Due within one year	¥1,012	¥1,016	$ 8,426
Due after one year	1,673	1,782	13,924
Total	¥2,686	¥2,798	$22,350

Depreciation expense under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Depreciation expense	¥1,141	¥1,373	$9,498

Depreciation expense is calculated using the straight-line method with zero residual value.

The amounts of acquisition cost, obligations and depreciation expense includes interest expense portion, because of its immateriality.

The minimum rental commitments under noncancelable operating leases at March 31, 2003 and 2002, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Due within one year	¥8	¥71	$74
Due after one year			6
Total	¥9	¥71	$80

24. Derivatives

a. Derivatives Transactions

Derivative financial instruments dealt

Derivatives involve interest rate-related transactions (such as interest rate futures, interest rate options and interest rate swaps), currency related transactions (such as currency swaps, foreign exchange forward contracts and currency options), and stock and bond-related futures and options.

Policy and purpose to use derivatives

Derivative activities are significant to business operations. The Bank has been using derivatives actively, while controlling the various risks of derivatives, such as market and credit risks. The purpose of derivatives is to offer customers products to hedge market risks such as interest rate risk and foreign exchange risk and to take the Bank's own trading position by exploiting short-term fluctuations and differences among markets in interest rates, foreign exchange rates, securities prices and other factors. In order to stabilize and maximize earnings, the Bank also uses derivatives in ALM operations, maintaining interest rate risk and other risks of on-balance-sheet assets and liabilities at an appropriate level.

Risk associated with derivatives and risk management system for derivatives

The two most significant derivatives-related risks are market and credit risks. Market risk can cause loss due to the volatility of markets such as interest rates and foreign exchange. Credit risk occurs when the counter-parties to a transaction fail to fulfill their obligations under a contract. It is the Bank's policy to conduct comprehensive control of market risk and credit risk for on-balance-sheet and off-balance-sheet transactions, thereby maintaining a proper balance between risk and profitability. The risk management procedures are fully documented internally. Each business department conducts business operations and risk management in accordance with such procedures. Independently of business departments, the Risk Management Division monitors market risk and credit risk resulting from market transactions including derivatives, and submits regular reports to management. For market risk, the maximum estimated loss is calculated on a daily basis using the value-at-risk method and the result is monitored based on specified limits. If an actual loss exceeds a maximum estimate, causal analysis is conducted. During the 246 business days from April 2002 to March 2003 and the 245 business days from April 2001 to March 2002, the actual value-at-risk figure in trading operations at the head office were estimated as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Maximum	¥271	¥612	$2,255
Minimum	27	54	226
Average	142	204	1,178

As to credit risk, the exposure is calculated by the current exposure method, the sum of the replacement cost and the potential cost in connection with expected changes in market conditions, and is controlled together with credit risk related to on-balance-sheet transactions such as lending. These risks are managed in line with internal regulations. Credit risk equivalent amounts for capital adequacy ratio calculation purposes (based on a standard for domestic operations) as at March 31, 2003 and 2002, were estimated as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Currency related transactions	¥ 16,974	¥ 10,670	$ 141,217
Interest rate related transactions	187,014	192,313	1,555,858
Netting effect	(127,397)	(138,537)	(1,059,880)
Total	¥ 76,590	¥ 64,446	$ 637,195

Supplementation to market-value calculation

OTC derivatives in the trading account are valued in accordance with internal rules established in line with the Long-term Credit Bank Law Enforcement Regulations.

b. Fair Value of Derivatives Transactions

The Bank and consolidated subsidiaries had the following derivatives contracts, which were quoted on listed exchanges, outstanding at March 31, 2003 and 2002:

	Millions of Yen		Thousands of U.S. Dollars	
March 31, 2003	Contract or Notional Amount	Fair Value	Contract or Notional Amount	Fair Value
Interest rate contracts:				
Futures written	¥ 66,968	¥(190)	$ 557,138	$(1,581)
Futures purchased	39,529	89	328,863	743
Options written	540,900	181	4,500,000	1,509
Options purchased	540,900	421	4,500,000	3,503
Bonds contracts:				
Futures written	22,998	(131)	191,337	(1,096)
Futures purchased	8,355	3	69,517	29
Futures options written	15,000	65	124,792	540
Futures options purchased	5,000	9	41,597	74
Equity contracts:				
Futures index written	238	2	1,986	19
Futures index purchased	234	1	1,954	12
Options index purchased	850		7,071	6
March 31, 2002				
Interest rate contracts:				
Futures written	12,477	(9)		
Futures purchased	19,975	4		
Options purchased	39,975	6		
Bonds contracts:				
Futures written	49,038	(213)		
Futures purchased	47,269	7		
Futures options purchased	5,000	13		
Equity contracts:				
Futures index purchased	278	(1)		
Options index written	1,650	45		
Options index purchased	3,850	50		

The Bank and consolidated subsidiaries had the following derivatives contracts, which were not quoted on listed exchanges, outstanding at March 31, 2003 and 2002:

	Millions of Yen		Thousands of U.S. Dollars	
March 31, 2003	Contract or Notional Amount	Fair Value	Contract or Notional Amount	Fair Value
Interest rate contracts:				
Interest rate swaps:				
Receive fixed and pay floating	¥6,797,317	¥ 184,012	$56,550,065	$ 1,530,883
Receive floating and pay fixed	6,771,600	(186,105)	56,336,114	(1,548,297)
Receive floating and pay floating	4,200	(7)	34,941	(61)
Other written	148,470	116	1,235,199	966
Other purchased	155,895	757	1,296,968	6,300
Foreign exchange—Currency swaps	195,090	(92)	1,623,053	(767)
March 31, 2002				
Interest rate contracts:				
Interest rate swaps:				
Receive fixed and pay floating	6,570,953	199,385		
Receive floating and pay fixed	6,273,007	(204,174)		
Receive floating and pay floating	2,000			
Other written	189,222	114		
Other purchased	228,171	1,098		
Foreign exchange—Currency swaps	302,874	(315)		

The contracts or notional amounts of derivatives which are shown in the above table do not represent the amounts exchanged by the parties and do not measure the exposure of the Bank and consolidated subsidiaries to credit or market risk.

Derivative transactions for trading purposes are stated at fair value in the accompanying consolidated financial statements.

25. Per Share of Common Stock

Reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended March 31, 2003 and 2002, is as follows:

	Millions of Yen	Thousands of Shares	Yen	U.S. Dollars
Year Ended March 31, 2003	Net Income	Weighted-average Shares	EPS	
Basic EPS—Net income available to common stockholders	¥19,912	2,834,870	¥7.02	$0.05
Effect of dilutive securities—Preferred stocks	3,464	1,396,276		
Diluted EPS—Net income for computation	¥23,376	4,231,146	¥5.52	$0.04
Year Ended March 31, 2002				
Basic EPS—Net income available to common stockholders	¥15,238	2,834,870	¥5.37	
Effect of dilutive securities—Preferred stocks	3,464	1,396,276		
Diluted EPS—Net income for computation	¥18,703	4,231,146	¥4.42	

26. Subsequent Event—Appropriation of Retained Earnings

The following plan of the Bank for the appropriation of retained earnings surplus was approved at the ordinary stockholders meeting held on June 26, 2003:

	Millions of Yen	Thousands of U.S. Dollars
Appropriations—Legal reserve	¥ 692	$ 5,765
Year-end dividends:		
The fourth preferred, ¥5 ($0.04) per share	240	2,002
The fifth preferred, ¥3.72 ($0.03) per share	3,224	26,822
Total	¥4,157	$34,589

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Deloitte Touche Tohmatsu

INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Stockholders of
Aozora Bank, Ltd.:

We have audited the accompanying consolidated balance sheets of Aozora Bank, Ltd. and consolidated subsidiaries as of March 31, 2003 and 2002, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards, procedures and practices generally accepted and applied in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Aozora Bank, Ltd. and consolidated subsidiaries as of March 31, 2003 and 2002, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles and practices generally accepted in Japan.

Our audits also comprehended the translation of Japanese yen amounts into U.S. dollar amounts and, in our opinion, such translation has been made in conformity with the basis stated in Note 1. Such U.S. dollar amounts are presented solely for the convenience of readers outside Japan.

Deloitte Touche Tohmatsu

June 26, 2003

Income Analysis

Interest-Earning Assets and Interest-Bearing Liabilities

Years Ended March 31

(Millions of Yen, %)

	Average balance			Interest income/expense			Return/rates		
	2003	2002	Change	2003	2002	Change	2003	2002	Change
Balance of interest-earning assets	**4,937,007**	**5,037,623**	**(100,615)**	**84,172**	**88,956**	**(4,783)**	**1.70**	**1.76**	**(0.06)**
Loans and bills discounted	3,254,343	3,443,953	(189,609)	64,940	69,287	(4,346)	1.99	2.01	(0.01)
Securities	1,196,600	810,182	386,418	8,040	9,474	(1,434)	0.67	1.16	(0.49)
Call loans and bills bought	205,157	275,865	(70,707)	48	151	(102)	0.02	0.05	(0.03)
Receivables under resale agreements	180	—	180	0	—	0	0.00	—	0.00
Receivables under securities borrowing transactions	186,235	—	186,235	107	—	107	0.05	—	0.05
Cash and due from banks	30,646	87,172	(56,525)	514	951	(437)	1.67	1.09	0.58
Balance of interest-bearing liabilities	**4,880,686**	**4,471,601**	**409,084**	**24,596**	**29,450**	**(4,853)**	**0.50**	**0.65**	**(0.15)**
Debentures	1,635,804	2,075,628	(439,823)	12,613	18,531	(5,917)	0.77	0.89	(0.12)
Deposits	1,871,616	1,331,758	539,857	8,150	5,644	2,506	0.43	0.42	0.01
Certificates of deposit	418,451	540,217	(121,766)	549	495	54	0.13	0.09	0.03
Borrowed money	21,428	47,907	(26,479)	804	1,164	(359)	3.75	2.43	1.32
Commercial paper	90	4,931	(4,841)	0	11	(11)	0.07	0.23	(0.15)
Call money and bills sold	636,234	398,163	238,070	277	92	184	0.04	0.02	0.02
Payables under repurchase agreements	205,636	—	205,636	10	—	10	0.00	—	0.00
Payables under securities lending transactions	86,880	—	86,880	57	—	57	0.06	—	0.06

Fees and Commissions

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Net fees and commissions	**7,388**	**5,210**	**2,178**
Fees and commissions received	**8,123**	**5,777**	**2,345**
Debentures, deposits and loan operations	3,525	2,128	1,396
Foreign exchange operations	180	122	57
Securities-related operations	460	420	39
Agency services	803	421	381
Safekeeping and safe deposit box services	20	28	(8)
Guarantee operations	1,573	715	857
Fees and commissions paid	**734**	**567**	**167**
Foreign exchange operations	96	67	29

Trading Revenues

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Net trading revenues	**3,446**	**537**	**2,909**
Trading profits	**3,446**	**1,266**	**2,180**
Gains on trading securities	844	—	844
Gains on securities related to trading transactions	182	—	182
Gains on trading-related financial derivatives	1,816	859	957
Others	602	407	195
Trading losses	**—**	**728**	**(728)**
Losses on trading securities	—	376	(376)
Losses on securities related to trading transactions	—	352	(352)
Losses on trading-related financial derivatives	—	—	—
Others	—	—	—

Other Operating Income

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Net other operating income	**6,416**	**1,672**	**4,744**
Gains (losses) on foreign exchange transactions	853	(117)	970
Gains (losses) on bonds	1,799	169	1,629
Others	3,764	1,619	2,144

Non-Consolidated Financial Highlights [Five-Year Summary]

Years Ended March 31

(Millions of Yen)

	2003	2002	2001	2000	1999
Operating income	101,633	100,984	270,720	219,956	409,474
Ordinary profit (loss)	7,437	13,706	98,971	(113,703)	(3,560,709)
Net income (loss)	22,875	18,563	99,690	—	(467,161)
Capital stock	419,781	419,781	419,781	353,114	353,114
Number of outstanding shares (in thousands)					
Common stock	2,834,870	2,834,870	2,834,870	2,501,536	2,501,536
The 2nd preferred stock			—	102,000	102,000
The 3rd preferred stock			—	386,398	386,398
The 4th preferred stock	48,144	48,144	48,144	120,000	120,000
The 5th preferred stock	866,667	866,667	866,667		
Total stockholders' equity	496,918	476,166	459,690	—	—
Total assets	5,895,314	5,687,366	6,174,922	8,500,368	14,055,429
Debentures	1,473,126	1,470,193	2,472,528	3,684,002	4,206,525
Deposits	2,555,905	2,177,240	1,778,939	2,635,411	2,495,353
Loans and bills discounted	3,271,087	3,304,379	3,092,049	4,104,221	7,209,084
Securities	1,356,754	1,060,690	727,758	1,135,653	1,198,950
Total stockholders' equity per share (in yen)	75.08	67.76	61.94	—	—
Dividend per share (in yen)					
Common stock	—	—	—	—	—
The 2nd preferred stock			—	—	—
The 3rd preferred stock			—	—	—
The 4th preferred stock	5.00	5.00	5.00	—	—
The 5th preferred stock	3.72	3.72	1.86		
(Interim dividend per share (in yen))					
(Common stock)	(—)	(—)	(—)	(—)	(—)
(The 2nd preferred stock)			(—)	(—)	(—)
(The 3rd preferred stock)			(—)	(—)	(—)
(The 4th preferred stock)	(—)	(—)	(—)	(—)	(—)
(The 5th preferred stock)	(—)	(—)	(—)		
Net income (loss) per share (in yen)	6.84	5.32	36.31	—	(186.74)
Diluted net income per share (in yen)	5.40	4.90	29.81	—	—
Dividend payout ratio (%)	—	—	—	—	—
Capital adequacy ratio (domestic standard) (%)	13.26	14.00	15.10	—	—
Number of employees	1,370	1,376	1,438	1,582	2,050

Notes:
1. Up to and including the fiscal year ended March 31, 2002, total stockholders' equity per share was calculated by dividing total stockholders' equity at the fiscal year-end, less the product of the number of preferred shares issued and outstanding at the fiscal year-end and the issue price, by the number of common shares issued and outstanding at the fiscal year-end (excluding treasury stock in the fiscal year ended March 31, 2002). However, since total stockholders' equity in the Bank was nil (¥0) for the fiscal years ended March 31, 1999, and 2000, total stockholders' equity per share for those years is calculated by dividing total stockholders' equity at the fiscal year-end by the number of shares issued and outstanding at the fiscal year-end.
2. Up to and including the fiscal year ended March 31, 2002, net income (loss) per share was calculated by dividing net income (loss), less total dividends on preferred shares for the fiscal year ended March 31, 2002, by the average number of common shares issued and outstanding during the fiscal year (excluding treasury stock in the fiscal year ended March 31, 2002).
3. Diluted net income per share is not given for the fiscal year ended March 31, 1999, as the Bank recorded a net loss for that period. For the fiscal year ended March 31, 2000, diluted net income per share is not given as no net income (loss) was recorded for that period.
4. From the fiscal year ended March 31, 2002, treasury stock is not included in capital stock. For this reason, total stockholders' equity per share, net income (loss) per share and diluted net income per share are calculated after deducting the number of shares of treasury stock from the outstanding number of shares.
5. From the fiscal year ended March 31, 2003, total stockholders' equity per share, net income (loss) per share and diluted net income per share are calculated by applying Financial Accounting Standard No. 2, "Accounting Standard for Earnings per Share" and Financial Accounting Standards Implementation Guidance No. 4, "Implementation Guidance for Accounting Standard for Earnings per Share."
6. Number of employees does not include executive officers, locally hired overseas staff or the Bank's employees seconded to other firms.

Non-Consolidated Financial Review

1. Income Analysis

The accumulation of high-quality assets, in addition to progress in disposing of non-performing loans to maintain the soundness of the Bank's financial position, led to a decline in the average balance of loans and bills discounted. Yields from investments in marketable securities also fell. These factors led to a slight drop in net interest income. In contrast, net fees and commissions, including those derived from syndicated loan and receivables securitization operations, recorded robust growth. Net trading revenues also grew sharply.

Thanks to our efforts to control costs, general and administrative expenses remained at a similar level to the previous period. As a result, business profit before general loan-loss reserve increased ¥7.6 billion, to ¥33.5 billion.

After making appropriate write-offs and reserve provisions to deal with the disposal of non-performng loans, total credit-related expenses recorded a surplus of ¥1.4 billion. Included within this figure was a loss from problem loan disposal of ¥16.5 billion and gains from reversal of various reserves, totaling ¥18.0 billion. These reversals were the result of an improvement in asset quality owing to progress in disposing of problem loans.

As a result, non-consolidated net income grew ¥4.3 billion, to ¥22.9 billion.

Income Analysis

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Gross business profit	**72,208**	**64,741**	**7,467**
Net interest income	59,500	60,027	(526)
Net fees and commissions	6,229	3,956	2,272
Net trading revenues	3,446	558	2,888
Net other operating income	3,031	198	2,832
General and administrative expenses	**(38,729)**	**(38,816)**	**87**
Business profit before general loan-loss reserve	**33,479**	**25,925**	**7,554**
General loan-loss reserve (Note 1)	**—**	**(219)**	**219**
Business profit	**33,479**	**25,706**	**7,773**
Other income (loss)	**(26,042)**	**(11,999)**	**(14,042)**
Loss on disposal of problem loans	(16,536)	(6,433)	(10,103)
Gain and loss on stock transactions and loss on write-down of equity securities	(1,034)	(898)	(135)
Ordinary profit	**7,437**	**13,706**	**(6,268)**
Special income (loss)	**11,946**	**3,745**	**8,201**
Reduction in loan-loss reserve (Note 2)	17,610	3,614	13,995
Net provisions to reserve for credit losses on off-balance-sheet instruments	349	—	349
Income before income taxes	**19,384**	**17,451**	**1,933**
Current income taxes	**(146)**	**(38)**	**(108)**
Deferred income taxes	**3,638**	**1,150**	**2,488**
Net income	**22,875**	**18,563**	**4,312**
Total credit-related expenses (Note 3)	**1,422**	**(3,037)**	**4,460**

Notes: 1. General loan-loss reserve includes net provisions to reserve for credit risk on off-balance-sheet instruments.
2. Reductions in general loan-loss reserve in excess of additions thereto, a net gain, were accounted for as a special income item.
3. Credit-related expenses = Net provision to general loan-loss reserve + Disposal of problem loans + Reduction in loan-loss reserve + Net provisions to reserve for credit losses on off-balance-sheet instruments.

(1) Gross business profit

Gross business profit rose ¥7.5 billion, to ¥72.2 billion. Although net interest income was largely unchanged, strong growth in net fees and commissions, net trading revenues and net other operating income contributed to the increase.

a. Net interest income

By applying appropriate interest rates to loans and raising the efficiency of fund procurement, the interest rate spread between our deposits and loans improved. A decline in the average balance of loans outstanding, owing to disposal of non-perfoming loans, and lower yields on marketable securities, owing to falling market interest rates, led to a ¥526 million decline in net interest income, to ¥59.5 billion.

b. Net fees and commissions

Owing to large increases in fees derived from such operations as syndicated loans and committed lines of credit, net fees and commissions jumped ¥2.3 billion, to ¥6.3 billion.

c. Net trading revenues

Net trading revenues climbed ¥2.9 billion, to ¥3.4 billion. The Bank conducts these operations based on a comprehensive system of risk management.

d. Net other operating income

Net other operating income rose to ¥3.0 billion, mainly reflecting net income derived from such operations as transactions relating to Japanese government bonds and other bonds as well as foreign exchange transactions.

Gross Business Profit

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Net interest income	**59,500**	**60,027**	**(526)**
Interest income	84,113	89,329	(5,215)
Interest expenses	24,612	29,301	(4,689)
Net fees and commissions	**6,229**	**3,956**	**2,272**
Fees and commissions (income)	7,079	4,461	2,617
Fees and commissions (expenses)	849	505	344
Net trading revenues	**3,446**	**558**	**2,888**
Trading profits	3,446	1,287	2,159
Trading losses	—	729	(729)
Net other operating income	**3,031**	**198**	**2,832**
Other operating income	6,195	3,717	2,477
Other operating expenses	3,163	3,519	(355)
Gross business profit	**72,208**	**64,741**	**7,467**
Business profit	**33,479**	**25,706**	**7,773**

Notes: 1. Interest expenses excludes interest paid on money held in trust, which was nil (¥0) for the fiscal years ended March 31, 2002, and March 31, 2003. Fees and commissions (expenses) excludes bond redemption fees, which were ¥2 million in the fiscal year ended March 31, 2002, and ¥2 million in the fiscal year ended March 31, 2003.
2. Business profit is calculated by subtracting general loan-loss reserve and general and administrative expenses from gross business profit.

(2) General and administrative expenses

General and administrative expenses declined ¥87 million, to ¥38.7 billion. During the period under review, the Bank's cost reduction efforts included lowering personnel costs by remedying a mismatch in its personnel structure, reducing rental costs by vacating surplus office space and relocating some branches, as well as reviewing information system equipment requirements.

Operating Expenses

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Operating Expenses	**38,729**	**38,816**	**(87)**
Personnel	15,909	15,522	387
Property and equipment	21,331	21,859	(527)
Taxes	1,487	1,434	53

(3) Business profit

As mentioned previously, business profit before general loan-loss reserve increased, mainly owing to higher net fees and commissions and net trading revenues, while general and administrative expenses were successfully restrained. As there was no provision for general loan-loss reserve, business profit totaled ¥33.5 billion, an increase of ¥7.6 billion.

(4) Other loss

a. Loss on disposal of problem loans

Owing to progress in removing problem loans from the balance sheet, the Bank incurred a loss on disposal of problem loans of ¥16.5 billion. However, a reversal of the general loan-loss reserve, in accordance with Japanese generally accepted accounting principles, resulted in a surplus in that account of ¥17.6 billion, which was recorded as a special income item. Consequently, total credit-related expenses amounted to income of ¥1.4 billion.

b. Gain and loss on stock transactions and loss on write-down of equity securities

Gain and loss on stock transactions and loss on write-down of equity securities amounted to ¥1.0 billion.

Credit-Related Expenses

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
General loan-loss reserve	**—**	**(219)**	**219**
Other income:			
Expenses of problem loan disposals	(16,536)	(6,433)	(10,103)
Loan write offs	(11,927)	(4,795)	(7,131)
Loss on the sale of other receivables and other items	(4,609)	(1,637)	(2,971)
Special income:			
Reduction in loan-loss reserve	17,610	3,614	13,995
Net provisions to reserve for credit losses on off-balance-sheet instruments	349	—	349
Credit-related expenses	**1,422**	**(3,037)**	**4,460**

Gain and Loss on Stock Transactions and Write-Down of Equity Securities

Years Ended March 31

(Millions of Yen)

	2003	2002	Change
Gain and loss on stock transactions and write-down of equity securities	**(1,034)**	**(898)**	**(135)**
Gain on sale of equity securities	204	564	(359)
Loss on sale of equity securities	(615)	(962)	346
Write-down of equity securities	(623)	(500)	(122)

(5) Ordinary profit

Ordinary profit declined ¥6.3 billion, to ¥7.4 billion. This result was mainly attributable to the surplus from the reversal of general loan-loss reserve being posted as a special income item.

(6) Special income

Special income resulting from reversal of general loan-loss reserve was ¥17.6 billion. Partially offsetting this was a non-recurring depreciation of the Computer Center of ¥7.1 billion. Consequently, special income totaled ¥11.9 billion for the period under review.

(7) Net income

Income before income taxes grew ¥1.9 billion, to ¥19.4 billion. Current income taxes totaled ¥146 million and deferred income taxes were ¥3.6 billion. As a result, net income for the period under review amounted to ¥22.9 billion.

2. Assets and Liabilities

Assets and Liabilities

March 31

(Millions of Yen)

	2003	2002	Change
Assets	**5,895,314**	**5,687,366**	**207,948**
Loans and bills discounted	3,271,087	3,304,379	(33,291)
Securities	1,356,754	1,060,690	296,064
Trading assets	532,291	422,694	109,597
Call loans	27,744	78,611	(50,866)
Liabilities	**5,398,396**	**5,211,200**	**187,196**
Debentures	1,473,126	1,470,193	2,933
Deposits	2,138,399	1,649,332	489,066
Negotiable certificates of deposit	417,506	527,908	(110,402)
Call money and bills sold	574,895	728,500	(153,604)
Stockholders' equity	**496,918**	**476,166**	**20,752**

(1) Assets

The accumulation of high-quality assets, in addition to our efforts to dispose of non-performing assets, led to an overall decline in loans and bills discounted of ¥33.3 billion, to ¥3,271.1 billion. Securities increased ¥296.1 billion, to ¥1,356.8 billion, mainly reflecting a rise in investments in Japanese government bonds. However, short-term surplus funds, such as call loans and due from banks, decreased. As a result, assets increased ¥207.9 billion, to ¥5,895.3 billion.

(2) Liabilities

As one of the Bank's main financing methods, debentures were relatively steady, posting a slight increase of ¥2.9 billion, to ¥1,473.1 billion. Deposits climbed ¥489.1 billion, to ¥2,138.4 billion. This result reflected a rise in large-balance corporate time deposits as well as strong growth in our retail product Aozora Direct Time Deposit. Consequently, liabilities rose ¥187.2 billion, to ¥5,398.4 billion.

(3) Stockholders' equity

A significant increase in retained earnings resulted in an increase in stockholders' equity of ¥20.8 billion, to ¥496.9 billion.

3. Non-Consolidated Capital Adequacy Ratio (Domestic Standard)

March 31

(Millions of Yen)

		2003	2002
Tier I	Capital	419,781	419,781
	Non-cumulative perpetual preferred stock	272,036	272,036
	Newly issued stock	—	—
	Capital surplus	33,333	33,333
	Other capital surplus	—	—
	Legal reserve	1,756	1,063
	Voluntary reserve	—	—
	Profit carried forward to next term	37,501	18,170
	Others	—	785
	Net unrealized losses on available-for-sale securities	—	(235)
	Paid-in amount on treasury stock	—	—
	Treasury stock	(0)	(0)
	Goodwill	—	—
	Total (A)	**492,372**	**472,899**
	Step-up preferred stock	—	—
Tier II	Forty-five percent of the difference between fair value and book value in respect of land	—	—
	General reserve for possible loan losses	24,667	23,032
	Subordinated debt	6,598	20,317
	Total	**31,265**	**43,349**
	Tier II capital qualifying as capital (B)	**31,265**	**43,349**
Items deducted	**(C)**	**—**	**—**
Capital	**(A) + (B) – (C) (D)**	**523,637**	**516,248**
Risk-weighted assets	Balance-sheet exposure	3,821,930	3,584,717
	Off-balance-sheet exposure	124,807	100,495
	Total (E)	**3,946,738**	**3,685,213**
Capital adequacy ratio (domestic standard)	$\frac{(D)}{(E)}$ **x 100**	**13.26%**	**14.00%**
Tier I ratio (domestic standard)	$\frac{(A)}{(E)}$ **x 100**	**12.47%**	**12.83%**

Note: The capital adequacy ratio is calculated using the formula stipulated in a Ministry of Finance Notification based on Article 14-2 of the Banking Law, which follows the provisions of Article 17 of the Long-Term Credit Bank Law. The Bank uses the domestic standard.

Non-Consolidated Balance Sheets (Unaudited)

Aozora Bank, Ltd.
March 31, 2003 and 2002

ASSETS	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Cash and cash equivalents	¥ 290,732	¥ 557,257	$ 2,418,742
Due from banks	79,513	47,384	661,506
Call loans and bills bought	27,744	78,611	230,817
Receivables under securities borrowing transactions	166,730		1,387,109
Commercial paper and other debt purchased	73,867	32,041	614,537
Trading account assets	532,291	422,694	4,428,383
Money held in trust			8
Securities	1,356,754	1,060,690	11,287,475
Loans and bills discounted	3,271,087	3,304,379	27,213,708
Foreign exchanges	2,956	9,440	24,600
Other assets	133,179	282,968	1,107,984
Premises and equipment	32,098	33,045	267,043
Deferred charges	184	289	1,537
Customers' liabilities for acceptances and guarantees	114,222	141,354	950,269
Deferred tax assets	13,270	10,432	110,404
Reserve for possible loan losses	(199,320)	(293,223)	(1,658,241)
TOTAL	¥5,895,314	¥5,687,366	$49,045,881

LIABILITIES AND STOCKHOLDERS' EQUITY	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
LIABILITIES:			
Debentures	¥1,473,126	¥1,470,193	$12,255,631
Deposits	2,555,905	2,177,240	21,263,772
Call money and bills sold	574,895	728,500	4,782,826
Payables under repurchase agreements	204,797		1,703,807
Commercial paper	3,000		24,958
Trading account liabilities	140,642	162,318	1,170,074
Borrowed money	23,495	44,195	195,466
Foreign exchanges	127	129	1,059
Other liabilities	289,987	470,625	2,412,537
Liability for employees' retirement benefits	17,571	15,668	146,182
Reserve for credit losses on off-balance-sheet instruments	625	974	5,200
Other reserves			2
Acceptances and guarantees	114,222	141,354	950,269
Total liabilities	5,398,396	5,211,200	44,911,783
STOCKHOLDERS' EQUITY:			
Capital stock:			
Common stock	147,745	147,745	1,229,161
Preferred stock	272,036	272,036	2,263,195
Capital surplus	33,333	33,333	277,316
Retained earnings	42,697	23,286	355,219
Unrealized gain (loss) on available-for-sale securities	1,106	(235)	9,207
Total stockholders' equity	496,918	476,166	4,134,098
TOTAL	¥5,895,314	¥5,687,366	$49,045,881

Non-Consolidated Statements of Income (Unaudited)

Aozora Bank, Ltd.

Years Ended March 31, 2003 and 2002

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
INCOME:			
Interest on:			
Loans and discounts	¥ 64,609	¥ 69,395	$ 537,513
Securities	8,365	9,895	69,595
Deposits with banks	514	951	4,279
Other	10,624	9,085	88,393
Fees and commissions	7,079	4,461	58,896
Trading account profits	3,446	1,287	28,676
Other operating income	6,195	3,717	51,540
Other income	20,187	6,336	167,950
Total income	121,022	105,133	1,006,842
EXPENSES:			
Interest on:			
Debentures	12,629	18,028	105,067
Deposits	8,702	6,142	72,402
Borrowings and rediscounts	1,080	1,609	8,990
Commercial paper		11	1
Other	2,200	3,510	18,305
Fees and commissions	852	507	7,089
Trading account losses		729	
Other operating expenses	3,160	3,516	26,294
General and administrative expenses	40,288	39,008	335,178
Other expenses	32,724	14,618	272,249
Total expenses	101,638	87,682	845,575
INCOME BEFORE INCOME TAXES	19,384	17,451	161,267
INCOME TAXES			
Current	146	38	1,221
Deferred	(3,638)	(1,150)	(30,266)
Total income taxes	(3,491)	(1,111)	(29,045)
NET INCOME	¥ 22,875	¥ 18,563	$ 190,312

	Yen		U.S. Dollars
	2003	2002	2003
PER SHARE OF COMMON STOCK:			
Net income	¥6.84	¥5.32	$0.05
Diluted net income	5.40	4.38	0.04
Cash dividends of the fourth preferred stock	5.00	5.00	0.04
Cash dividends of the fifth preferred stock	3.72	3.72	0.03

Non-Consolidated Statements of Earned Surplus (Unaudited)

Aozora Bank, Ltd.
Years Ended March 31, 2003 and 2002

	Millions of Yen		Thousands of U.S. Dollars
	2003	2002	2003
Balance at beginning of year	¥22,915	¥ 6,576	$190,647
Appropriation (Disposition)			
Cash dividends	(3,464)	(1,852)	(28,824)
Transfer to legal reserve	(692)	(370)	(5,764)
Net income	22,875	18,563	190,312
Balance at end of year	¥41,633	¥22,915	$346,371

Debenture Operations

Outstanding Balance and Average Balance of Debentures

Years Ended March 31

(Millions of Yen)

	2003		2002	
	Term-end balance	Average balance	Term-end balance	Average balance
Aozora debentures	1,387,508	1,517,558	1,310,952	1,839,756
Discounted Aozora debentures . . .	85,618	121,246	159,240	227,045
Total	**1,473,126**	**1,638,804**	**1,470,193**	**2,066,802**

Note: Debentures do not include debenture subscriptions.

Balance by Residual Period

March 31

(Millions of Yen)

	2003			2002		
	Total	Aozora Discounted	Discounted Aozora debentures	Total	Aozora Discounted	Discounted Aozora debentures
Less than 1 year	1,120,036	1,034,713	85,322	991,105	831,864	159,240
1 – 3 years	286,137	285,842	295	397,300	397,300	
3 – 5 years	66,930	66,930		81,787	81,787	
5 – 7 years	23	23		—	—	
Over 7 years	—	—		—	—	
Total	**1,473,126**	**1,387,508**	**85,618**	**1,470,193**	**1,310,952**	**159,240**

Deposit Operations

Balance by Deposit Account

Years Ended March 31

(Millions of Yen)

			2003			2002		
			Total	Domestic operations	International operations	Total	Domestic operations	International operations
Deposits								
	Liquid deposits	Average balance	**513,763**	**513,763**	**—**	235,030	235,030	—
		(%)	**(27.18)**	**(27.65)**	**—**	(17.48)	(17.97)	—
		Term-end balance	**603,836**	**603,836**	**—**	616,754	616,754	—
		(%)	**(28.24)**	**(28.33)**	**—**	(37.39)	(38.25)	—
	Interest-bearing deposits	Average balance	465,728	465,728	—	206,223	206,223	—
		(%)	(24.64)	(25.07)	—	(15.34)	(15.77)	—
		Term-end balance	491,509	491,509	—	502,349	502,349	—
		(%)	(22.98)	(23.06)	—	(30.46)	(31.16)	—
	Time deposits	Average balance	**1,367,800**	**1,342,225**	**25,574**	1,101,717	1,070,556	31,160
		(%)	**(72.36)**	**(72.24)**	**(78.84)**	(81.95)	(81.87)	(84.94)
		Term-end balance	**1,510,515**	**1,510,515**	**—**	1,023,038	992,597	30,441
		(%)	**(70.64)**	**(70.86)**	**—**	(62.03)	(61.57)	(81.96)
	Deregulated interest rate time deposits (fixed)	Average balance	1,176,656	1,176,656		1,016,783	1,016,783	
		(%)	(62.25)	(63.33)		(75.63)	(77.76)	
		Term-end balance	1,309,365	1,309,365		928,387	928,387	
		(%)	(61.23)	(61.43)		(56.29)	(57.59)	
	Deregulated interest rate time deposits (floating)	Average balance	165,569	165,569		53,773	53,773	
		(%)	(8.76)	(8.91)		(4.00)	(4.11)	
		Term-end balance	201,150	201,150		64,210	64,210	
		(%)	(9.41)	(9.44)		(3.89)	(3.98)	
	Others	Average balance	**8,781**	**1,919**	**6,862**	7,610	2,085	5,525
		(%)	**(0.46)**	**(0.10)**	**(21.16)**	(0.57)	(0.16)	(15.06)
		Term-end balance	**24,047**	**17,235**	**6,811**	9,540	2,841	6,698
		(%)	**(1.12)**	**(0.81)**	**(100.00)**	(0.58)	(0.18)	(18.04)
	Total	Average balance	**1,890,345**	**1,857,908**	**32,437**	1,344,358	1,307,672	36,685
		(%)	**(100.00)**	**(100.00)**	**(100.00)**	(100.00)	(100.00)	(100.00)
		Term-end balance	**2,138,399**	**2,131,587**	**6,811**	1,649,332	1,612,193	37,139
		(%)	**(100.00)**	**(100.00)**	**(100.00)**	(100.00)	(100.00)	(100.00)
Certificates of deposit		Average balance	**418,451**	**415,451**	**—**	540,217	540,217	—
		Term-end balance	**417,506**	**417,506**	**—**	527,908	527,908	—
Total		Average balance	**2,308,797**	**2,276,360**	**32,437**	1,884,575	1,847,890	36,685
		Term-end balance	**2,555,905**	**2,549,093**	**6,811**	2,177,240	2,140,101	37,139

Notes: 1. Time deposits (in general) = Time deposits
Deregulated interest rate time deposits (fixed) = Deregulated interest rate time deposits for which the interest up to the due date is determined when the deposits are made.
Deregulated interest rate time deposits (floating) = Deregulated interest rate time deposits for which the interest varies according to changes in market interest rates during the period of deposit.
2. Liquid deposits = Deposits at notice + Ordinary deposits + Current deposits
3. Average balance of domestic offices' foreign-currency denominated transactions in the international operations sector has been computed by the daily current method.

Balance of Time Deposits by Residual Period

March 31

(Millions of Yen)

	2003			2002		
	Total	Deregulated interest rate (fixed)	Deregulated interest rate (floating)	Total	Deregulated interest rate (fixed)	Deregulated interest rate (floating)
Less than 3 months	353,418	296,592	56,825	306,642	298,882	7,760
3 – 6 months	136,091	92,161	43,930	29,933	29,483	450
6 months – 1 year	375,610	316,110	59,500	130,368	95,927	4,000
1 – 2 years	163,015	129,370	33,644	349,020	308,570	40,450
2 – 3 years	105,204	101,404	3,800	138,248	127,398	10,850
More than 3 years	377,174	373,724	3,450	68,825	68,125	700
Total	**1,510,515**	**1,309,365**	**201,150**	**1,023,038**	**928,387**	**64,210**

Outstanding Balance by Depositor

March 31

(Millions of Yen, %)

	2003		2002	
	Balance	Share	Balance	Share
Corporations	591,270	27.67	551,244	34.09
Individuals	1,004,972	47.04	673,363	41.64
Public sector	92,244	4.32	36,909	2.29
Financial institutions	448,103	20.97	355,498	21.98
Total	**2,136,591**	**100.00**	**1,617,016**	**100.00**

Note: The above balance does not include certificates of deposit, deposits at overseas offices and specific international financial transaction accounts.

Loan Operations

Outstanding Balance of Loans

Years Ended March 31

(Millions of Yen)

		2003			2002		
		Total	Domestic operations	International operations	Total	Domestic operations	International operations
Loans on deeds	Average balance	2,263,930	2,213,448	50,482	2,342,087	2,302,301	39,785
	Term-end balance	2,440,493	2,388,298	52,194	2,211,767	2,164,008	47,759
Loans on notes	Average balance	841,021	840,533	487	979,105	978,604	500
	Term-end balance	658,342	657,861	480	921,047	920,514	533
Overdrafts	Average balance	162,060	162,060	—	114,677	114,677	—
	Term-end balance	166,727	166,727	—	166,893	166,893	—
Bills discounted	Average balance	5,553	5,553	—	3,646	3,646	—
	Term-end balance	5,524	5,524	—	4,669	4,669	—
Total	**Average balance**	**3,272,565**	**3,221,595**	**50,970**	**3,439,516**	**3,399,230**	**40,286**
	Term-end balance	**3,271,087**	**3,218,412**	**52,675**	**3,304,379**	**3,256,087**	**48,292**

Notes: 1. Average balance of domestic offices' foreign-currency denominated transactions in the international operations sector has been computed by the daily current method.

2. The Bank carries out partial and direct write-off of loans. This also applies to the table shown below.

Balance by Residual Period

March 31

(Millions of Yen)

	2003			2002		
	Total	Fixed interest	Floating interest	Total	Fixed interest	Floating interest
Less than 1 year	1,187,608			1,412,405		
1 – 3 years	723,871	501,948	221,923	632,734	516,580	116,154
3 – 5 years	809,208	549,988	259,219	704,658	500,490	204,167
5 – 7 years	245,298	157,093	88,204	234,471	184,910	49,560
Over 7 years	304,363	191,520	112,842	319,214	215,426	103,787
Indefinite period	736	—	736	894	—	894
Total	**3,271,087**			**3,304,379**		

Note: No distinction has been made between fixed interest and floating interest, as to loans with a residual period of less than 1 year.

Breakdown of Loans and Bills Discounted by Industry

March 31

(Number of Borrowers, Millions of Yen, %)

	2003			2002		
	Number of borrowers	Balance of loans	Share	Number of borrowers	Balance of loans	Share
Loans by domestic offices						
(excluding Japan Offshore Market accounts)	**5,891**	**3,238,635**	**100.00**	**6,157**	**3,286,793**	**100.00**
Manufacturing	529	478,405	14.77	552	512,078	15.58
Agriculture, forestry and fisheries	8	7,883	0.24	11	4,567	0.14
Mining	13	11,688	0.36	14	12,745	0.39
Construction	108	153,839	4.75	112	207,667	6.32
Utilities	33	17,648	0.55	30	25,139	0.76
Transport and communications				173	278,237	8.46
Information and communications	147	70,109	2.16			
Transport	169	312,489	9.65			
Wholesale, retail and restaurants				518	334,288	10.17
Wholesale and retail	469	340,694	10.52			
Financial and insurance	103	464,015	14.33	108	489,552	14.89
Real estate	392	732,163	22.61	385	730,212	22.22
Services	713	599,553	18.51	653	638,474	19.43
Local government	1	1,200	0.04	—	—	—
Others	3,206	48,943	1.51	3,601	53,830	1.64
Loans by overseas offices						
(including Japan Offshore Market accounts)	**24**	**32,452**	**100.00**	**17**	**17,586**	**100.00**
Governments and official institutions	—	—	—	—	—	—
Financial institutions	—	—	—	—	—	—
Commercial & industrial	24	32,452	100.00	17	17,586	100.00
Others	—	—	—	—	—	—
Total	**5,915**	**3,271,087**		**6,174**	**3,304,379**	

Note: The Japan Standard Industrial Classification was revised by the Ministry of Public Management, Home Affairs, Posts and Telecommunications by Public Notice No. 139, released on March 7, 2002, effective October 1, 2002. Consequently, the breakdown of loans and bills discounted by industry for domestic offices, excluding Japan Offshore Market (JOM) accounts, is based on the pre-revision classification as of March 31, 2002, and based on the revised classification as of March 31, 2003.

Breakdown of Loans and Bills Discounted by Collateral

March 31

(Millions of Yen)

	2003	2002
Securities	37,108	48,830
Claims	617,301	624,765
Merchandise	10	—
Land and buildings	853,542	930,167
Factories	766	1,565
Foundations	275,360	274,175
Vessels	21,128	14,413
Others	897,046	793,737
Total	**2,702,263**	**2,687,655**
Guarantees	177,893	140,902
Credits	390,930	475,821
Total	**3,271,087**	**3,304,379**

Note: Includes collateral in which the Bank has a third-party perfected security interest

Write-Off of Loans

March 31

(Millions of Yen)

	2003	2002
Write-off of loans	**11,927**	**4,795**

Reserves for Possible Loan Losses

Years Ended March 31

(Millions of Yen)

	2003					2002				
			Reduction during year					Reduction during year		
	Balance at beginning of year	Provision	Used for specific purpose	Other	Balance at end of year	Balance at beginning of year	Provision	Used for specific purpose	Other	Balance at end of year
General reserve for possible loan losses	175,688	167,564	—	175,688	167,564	190,586	175,688	—	190,586	175,688
Specific reserve for possible loan losses	116,882	30,412	76,292	40,589	30,412	(10) 166,291	116,882	60,039	106,252	116,882
Possible loan losses related to non-residents	—	—	—	—	—	(10) 277	—	—	277	—
Provision for country risk reserve	653	1,343	—	653	1,343	—	653	—	—	653

Note: Figures enclosed in parentheses in the column showing figures for balances at beginning of the year represent the difference arising from foreign currency translation adjustments.

Country Risk Reserve

March 31

(Millions of Yen)

	2003	2002
Indonesia	8,725	4,589
Total	**8,725**	**4,589**
(Percentage of total assets)	**(0.14%)**	**(0.08%)**

Note: Receivables associated with specific overseas countries consist of loans and bills discounted, and are provided for as reserves for possible loan losses (country risk reserve).

Securities

Outstanding Balance and Average Balance of Securities Held

Years Ended March 31

(Millions of Yen)

		2003			2002		
		Total	Domestic operations	International operations	Total	Domestic operations	International operations
Total	**Average balance**	**1,204,002**	**981,562**	**222,440**	**818,460**	**667,868**	**150,592**
	(%)	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**
	Term-end balance	**1,356,754**	**1,140,692**	**216,061**	**1,060,690**	**841,540**	**219,149**
	(%)	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**	**(100.00)**
National government bonds	Average balance	836,904	836,904	—	558,349	558,349	—
	(%)	(69.51)	(85.26)	—	(68.22)	(83.60)	—
	Term-end balance	965,515	965,515	—	733,992	733,992	—
	(%)	(71.16)	(84.64)	—	(69.20)	(87.22)	—
Local government bonds	Average balance	36,039	36,039	—	12,455	12,455	—
	(%)	(2.99)	(3.67)	—	(1.52)	(1.87)	—
	Term-end balance	70,987	70,987	—	6,649	6,649	—
	(%)	(5.23)	(6.22)	—	(0.63)	(0.79)	—
Short-term corporate bonds	Average balance	—	—	—			
	(%)	—	—	—			
	Term-end balance	—	—	—			
	(%)	—	—	—			
Corporate bonds	Average balance	77,146	77,146	—	68,656	68,656	—
	(%)	(6.41)	(7.86)	—	(8.39)	(10.28)	—
	Term-end balance	77,943	77,943	—	68,062	68,062	—
	(%)	(5.74)	(6.83)	—	(6.42)	(8.09)	—
Stocks	Average balance	9,268	9,268	—	10,584	10,584	—
	(%)	(0.77)	(0.94)	—	(1.29)	(1.58)	—
	Term-end balance	8,631	8,631	—	9,772	9,772	—
	(%)	(0.64)	(0.76)	—	(0.92)	(1.16)	—
Others	Average balance	244,643	22,203	222,440	168,413	17,821	150,592
	(%)	(20.32)	(2.27)	(100.00)	(20.58)	(2.67)	(100.00)
	Term-end balance	233,676	17,614	216,061	242,212	23,063	219,149
	(%)	(17.23)	(1.55)	(100.00)	(22.83)	(2.74)	(100.00)

Notes: 1. Total for Others is the sum of Domestic operations and International operations.
2. Average balance of domestic offices' foreign-currency denominated transactions in international operations is computed by the daily current method.

Balance of Securities by Residual Period

March 31

(Millions of Yen)

	2003						2002					
	National government bonds	Local government bonds	Short-term corporate bonds	Corporate bonds	Stocks	Others	National government bonds	Local government bonds	Short-term corporate bonds	Corporate bonds	Stocks	Others
Less than 1 year	569,751	64,700	—	7,163		22,339	292,971	115		3,511		29,192
1 – 3 years	158,578	480	—	34,031		69,721	340,290	3,577		21,881		54,826
3 – 5 years	206,552	1,920	—	21,729		82,106	100,731	813		27,529		90,083
5 – 7 years	25,182	741	—	11,233		6,500	—	1,006		10,429		17,926
7 – 10 years	5,451	2,629	—	3,785		1,202	—	552		4,711		4,232
Over 10 years	—	515	—	—		30,738	—	584		—		25,282
Indefinite period	—	—	—	—	8,631	21,069	—	—		—	9,772	20,671
Total	**965,515**	**70,987**	**—**	**77,943**	**8,631**	**233,676**	**733,992**	**6,649**		**68,062**	**9,772**	**242,212**

Derivative Transactions

Notes: 1. The Bank applies the “risk adjustment approach” specified by the JICPA as a hedge accounting method (macro hedge), to control the interest rate risk arising from the Bank’s extensive portfolio of financial assets and liabilities.
2. Unrealized gains or losses on hedging instruments that qualify for hedge accounting are shown below.
3. The appraisal value of interest rate swaps is posted to the income statement. This included accrued interest on interest rate swap transactions of ¥548 million for the fiscal year ended March 31, 2002, and ¥1,349 million for the fiscal year ended March 31, 2003.

Interest Rate Swaps

Years Ended March 31

(Millions of Yen)

	2003				2002			
	Contract amount				Contract amount			
		Over one year	Fair value	Valuation gains (losses)		Over one year	Fair value	Valuation gains (losses)
Total	**4,000,712**	**3,350,712**	**28,614**	**28,614**	**2,959,373**	**2,867,373**	**21,589**	**21,589**
Receivable fixed rate/ Payable floating rate	2,449,000	1,874,000	74,303	74,303	1,926,000	1,905,000	79,753	79,753
Receivable floating rate/ Payable fixed rate	1,551,712	1,476,712	(45,688)	(45,688)	1,033,373	962,373	(58,163)	(58,163)
Receivable floating rate/ Payable floating rate	—	—	—	—	—	—	—	—

Interest Rate Futures

Years Ended March 31

(Millions of Yen)

	2003				2002			
	Contract amount				Contract amount			
		Over one year	Fair value	Valuation gains (losses)		Over one year	Fair value	Valuation gains (losses)
Total	**—**	**—**	**—**	**—**	**101,743**	**—**	**(1)**	**(1)**
Bought	—	—	—	—	53,368	—	(13)	(13)
Sold	—	—	—	—	48,374	—	12	12

Capitalization

History of Capitalization

(Millions of Yen)

Month/Year	Capital increases	Capital thereafter	Remarks
Mar. 1988	2,694	96,364	Conversion of convertible bonds (Nov. 2, 1987–Mar. 31, 1988)
Oct. 1988	2,321	98,686	Conversion of convertible bonds (Apr. 1, 1988–Oct. 31, 1988)
Nov. 1988	27,985	126,671	Compensatory public subscription, 5,000 thousand shares; Issue price ¥11,194; Transfer to capital ¥5,597
Mar. 1989	1,415	128,086	Conversion of convertible bonds (Nov. 1, 1988–March 31, 1989)
Mar. 1990	20,290	148,377	Conversion of convertible bonds (Apr. 1, 1989–March 31, 1990)
Mar. 1991	3,814	152,191	Conversion of convertible bonds (Apr. 1, 1990–March 31, 1991)
Mar. 1992	28	152,220	Conversion of convertible bonds (Apr. 1, 1991–March 31, 1992)
Mar. 1995	71	152,292	Conversion of convertible bonds (Apr. 1, 1994–March 31, 1995)
Oct. 1996	25,500	177,792	Compensatory private placement (the 2nd preferred stock, 102,000 thousand shares); Issue price ¥500; Transfer to capital ¥250
Jul. 1997	83,498	261,290	Compensatory private placement (common stock, 766,039 thousand shares); Issue price ¥218; Transfer to capital ¥109
Jul. 1997	61,823	323,114	Compensatory private placement (the 3rd preferred stock, 386,398 thousand shares); Issue price ¥320; Transfer to capital ¥160
Mar. 1998	30,000	353,114	Compensatory private placement (the 4th preferred stock, 120,000 thousand shares); Issue price ¥500; Transfer to capital ¥250
Sep. 2000	66,666	419,781	Compensatory private placement (common stock, 333,334 thousand shares); Issue price ¥300; Transfer to capital ¥200
Oct. 2000	(260,000)	159,781	Non-compensatory reduction of capital • Capital reduction of ¥105,287 million by redemption of the 2nd preferred stock, 102,000 thousand shares; the 3rd preferred stock, 386,398 thousand shares; and the 4th preferred stock, 71,856 thousand shares • Capital reduction of ¥154,712 million exceeding face amount of common stock and transferred to capital
Oct. 2000	260,000	419,781	Compensatory private placement (the 5th preferred stock, 866,667 thousand shares); Issue price ¥300; Transfer to capital ¥300

Major Shareholders

(As of March 31, 2003)

a. Common Stock

	Number of shares held	Share of total outstanding shares
SOFTBANK CORP.	1,385,548 thousand	48.87%
ORIX Corporation	425,041	14.99
The Tokio Marine and Fire Insurance Co., Ltd.	425,041	14.99
Cerberus NCB Acquisition LLC	340,800	12.02
UBS Capital Asia Pacific Ltd.	14,200	0.50
Silicon Valley Bancshares	7,100	0.25
Shinkin Central Bank	5,680	0.20
The Shinkumi Federation Bank	5,680	0.20
The Rokinren Bank	5,680	0.20
THE MICHINOKU BANK, LTD.	5,680	0.20
The Hachijuni Bank, Ltd.	5,680	0.20
THE SURUGA BANK, LTD.	5,680	0.20
The Bank of Kyoto, Ltd.	5,680	0.20
The Chugoku Bank, Limited	5,680	0.20
The Hiroshima Bank, Ltd.	5,680	0.20
The Yamaguchi Bank, Ltd.	5,680	0.20
THE BANK OF FUKUOKA, LTD.	5,680	0.20
THE NISHI-NIPPON BANK, LTD.	5,680	0.20
The Fukuoka City Bank, Ltd.	5,680	0.20

Note: Cerberus NCB Acquisition LLC changed its name to Cerberus NCB Acquisition LP on June 4, 2003.

b. The 4th Preferred Stock

	Number of shares held	Share of total outstanding shares
Deposit Insurance Corporation	48,144 thousand	100.00%
Total	48,144 thousand	100.00%

c. The 5th Preferred Stock

	Number of shares held	Share of total outstanding shares
Resolution and Collection Corporation	866,667 thousand	100.00%
Total	866,667 thousand	100.00%

Corporate History

April	**1957**	Established as The Nippon Fudosan Bank, Limited (Capital: ¥1 billion) in accordance with the Long-term Credit Bank Law
November		Started issuance of debentures
September	**1958**	Started issuance of discount debentures
July	**1964**	Started foreign exchange business as an authorized foreign exchange bank
September		Listed stock on the Tokyo Stock Exchange
February	**1970**	Listed stock on the Osaka Securities Exchange
October	**1977**	Changed name to The Nippon Credit Bank, Ltd.
May	**1991**	Established NCB Private Equity Co., Ltd. (currently Aozora Investment Co., Ltd.)
February	**1994**	Established The Nippon Credit Trust Bank, Ltd. (currently Aozora Trust Bank, Ltd.), the first domestic subsidiary classified as other type of business
December	**1998**	Started special public management in accordance with the Financial Reconstruction Law and terminated listing of stock on the Tokyo Stock Exchange and the Osaka Securities Exchange
June	**1999**	Established NCB Servicer Co., Ltd. (currently AOZORA Loan Services Co., Ltd.), and commenced servicer operations in September 1999
June	**2000**	Share Purchase Agreement regarding the transfer of the Bank’s shares is signed between DIC and SOFTBANK CORP., ORIX Corporation, The Tokio Marine and Fire Insurance Co., Ltd., and other financial institutions
September		Ended special public management
November		Commenced telephone banking services
January	**2001**	Changed name to Aozora Bank, Ltd.
April		Launched Aozora Direct Time Deposit as a product exclusively available through telephone banking
December		Aozora Card Co., Ltd. was jointly established by ORIX Corporation and ORIX Credit Corporation
January	**2002**	Adopted AOZORA, a blue elephant, as the Bank’s mascot
October		Commenced over-the-counter sales of personal pension life insurance policies
January	**2003**	Began issuing collateralized loan obligations (CLOs)
March		Moved headquarters
April		Announced the Trinity Plan management strategy

Business Activities

- **Debentures**

  Issuance of debentures and discounted debentures

- **Deposits**

  Deposits

  Checking accounts, savings accounts, time deposits, deposits-at-notice, tax-savings deposits, non-residents deposits in yen and deposits in foreign currencies

  Certificates of deposit

  Limited to national and local public entities, bond management firms and other specified customers

- **Lending and guarantee of liabilities**

  Loans, discounts on promissory notes, guarantee of liabilities for equipment funds and long-term operating fund services

  Loans for long-term funds (term exceeding six months) other than equipment funds and long-term operating funds

  Loans for short-term funds (term of less than six months) are limited to the total amount of deposits or corresponding funds

  Discounts on promissory notes, guarantee of liabilities and acceptance of promissory notes

- **Securities**

  Security investment business

  Underwriting of public bonds

  Over-the-counter sales of public bonds, including national government bonds, and securities investment trusts

  Sales/Purchase of security products

  Receipt of payment for stocks or corporate bonds, and payment of dividends

  Registration of public bonds as a registered institution under the Corporate Bonds Registration Law

  Consignment business for soliciting or managing public bonds

  Trust business for secured corporate bonds

- **Domestic exchange**

  Such services as money orders between branches of the Bank and those of other banks, current account remittances, collection of payments, etc.

- **Foreign exchange**

  Remittance to foreign countries and other foreign currency-related businesses

- **Other services**

  Revenue agency for Bank of Japan and agency business for national bonds

  Receipt of public funds of local public entities, including Tokyo

  Agency business for Japan Small Business Corp., Employees Retirement Allowance Corp., Environmental Service Corp., Government Pension Investment Fund Employment Promotion Corp., Oil Corp., and Social Welfare Medical Corp.

  Custody services

  Rental of safe-deposit boxes

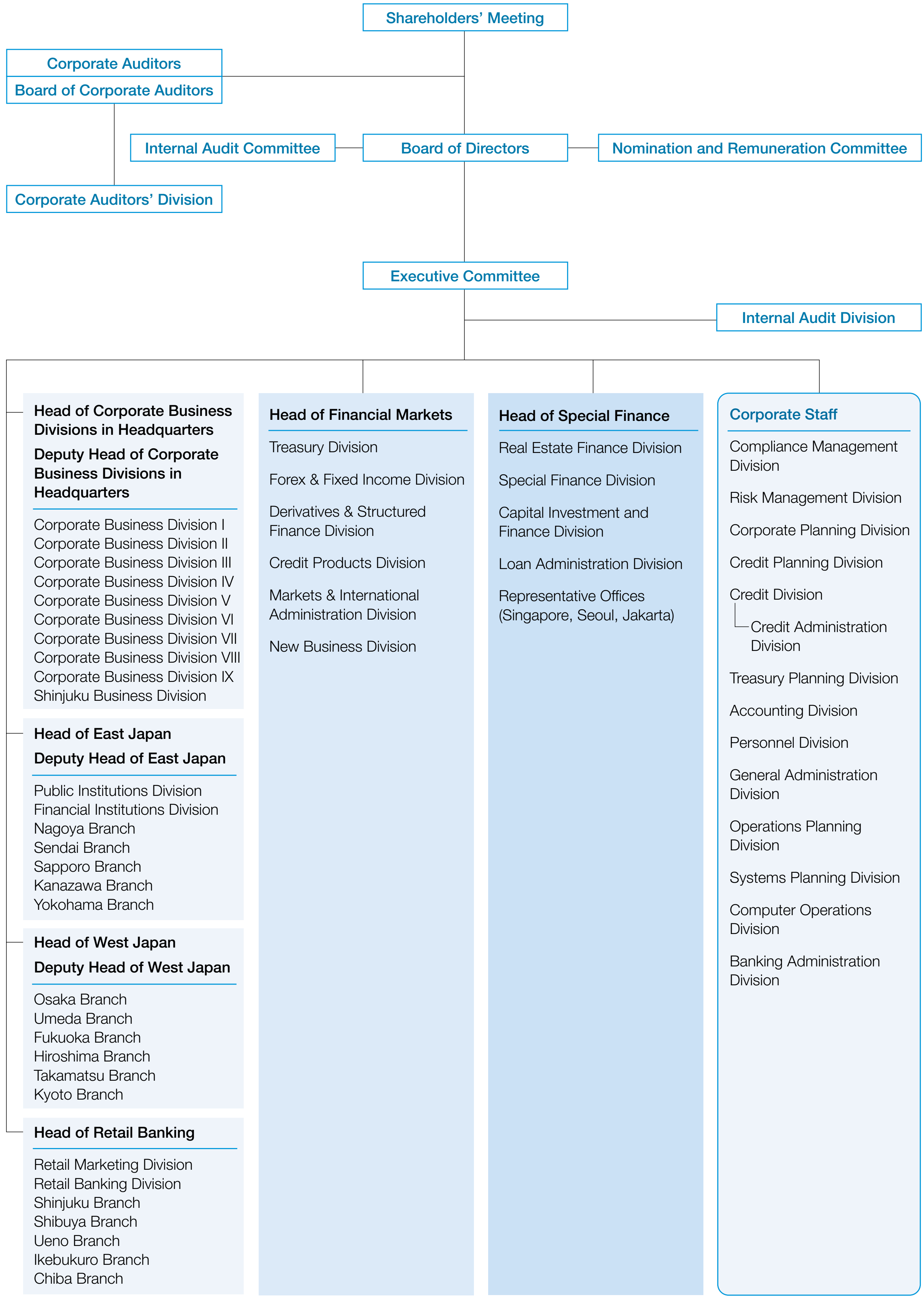
  Lending of securities

  Commercial paper

  Interest rate, currency and other derivative transactions

Organization Chart

(As of June 26, 2003)



Office Directory

(As of March 31, 2003)

Overseas Network

Representative Offices

Singapore Representative Office

Head of South East Asia
Masanao Kobayashi

Address
6 Temasek Boulevard, #23-02
Suntec Tower 4,
Singapore 038986,
Singapore
Tel: 6333-6781
Fax: 6333-6807

Seoul Representative Office

Senior Representative
Masayuki Ohga

Address
12th Floor
Kyobo Building, 1 Chongoro,
1-ka, Chongoro-ku,
Seoul 110-714
Republic of Korea
Tel: 02-734-8120
Fax: 02-734-8126

Jakarta Representative Office

Chief Representative
Hiroshi Matsumoto

Address
17th Floor, Jakarta Stock
Exchange Building Tower II
Jl. Jend. Sudirman Kav.
52-53, Jakarta 12190,
Indonesia
Tel: 021-515-5155
Fax: 021-515-5156

Domestic Network

HEAD OFFICE

3-1, Kudan-minami 1-chome,
Chiyoda-ku, Tokyo
102-8660, Japan
Tel: 03-3263-1111
Telex: J26921, J28788
(General)
NCBTOK
SWIFT: NCBTJPJT

BRANCH OFFICES

Osaka

2-4, Nishi-Shinsaibashi 1-chome,
Chuo-ku, Osaka 542-0086
Tel: 06-6245-2121

Nagoya

5-28, Meieki 4-chome,
Nakamura-ku, Nagoya 450-0002
Tel: 052-566-1900

Fukuoka

14-18, Tenjin 1-chome,
Chuo-ku, Fukuoka 810-0001
Tel: 092-751-9627

Sendai

2-1, Chuo 3-chome,
Aoba-ku, Sendai 980-0021
Tel: 022-225-1171

Hiroshima

13-13, Motomachi,
Naka-ku, Hiroshima 730-0011
Tel: 082-211-0125

Sapporo

1-4, Kita Sanjo-Nishi 4-chome,
Chuo-ku, Sapporo 060-0003
Tel: 011-241-8171

Takamatsu

6-1, Bancho 1-chome,
Takamatsu 760-0017
Tel: 087-821-5521

Kanazawa

37, Takaokacho 2-chome,
Kanazawa 920-0864
Tel: 076-231-4151

Shinjuku

37-11, Shinjuku 3-chome,
Shinjuku-ku, Tokyo 160-0022
Tel: 03-3354-1600

Umeda

47, Kakutacho 8-chome,
Kita-ku, Osaka 530-0017
Tel: 06-6315-1111

Yokohama

4-1, Kita-saiwai 1-chome,
Nishi-ku, Yokohama 220-0044
Tel: 045-319-1588

Kyoto

Oike-Kado,
Kawaramachi-dori,
Nakagyo-ku, Kyoto 604-8006
Tel: 075-211-3341

Shibuya

24-12, Shibuya 1-chome,
Shibuya-ku, Tokyo 150-0002
Tel: 03-3409-6411

Ueno

6-12, Ueno 2-chome,
Taito-ku, Tokyo 110-0005
Tel: 03-3835-7511

Ikebukuro

28-13, Minami-Ikebukuro
2-chome, Toshima-ku,
Tokyo 171-0022
Tel: 03-3988-0911

Chiba

3-1, Fujimi 2-chome,
Chuo-ku, Chiba 260-0015
Tel: 043-227-3111

Web site: http://www.aozorabank.co.jp/

Business Network
(As of March 31, 2003)

*All companies listed below are consolidated subsidiaries.

Aozora Bank, Ltd.

- **Banking operations**
  - Head Office and branches
  - Main affiliates: (Aozora Trust Bank, Ltd.)
- **Securities services**
  - Head Office and branches
- **Trust services**
  - Main affiliates: Aozora Trust Bank, Ltd. — *Trust services, banking operations*
- **Other operations**
  - Main affiliates:
    - AOZORA Loan Services Co., Ltd. — *Distressed loan servicing*
    - Aozora Card Co., Ltd. — *Card loan services*
    - Aozora Investment Co., Ltd. — *Venture capital investment*
    - Aozora Business Service Co., Ltd. — *Administrative temporary staff services*
    - Aozora Information Systems Co., Ltd. — *Systems development*

Subsidiaries at a Glance
(As of June 26, 2003)

(Millions of Yen, %)

Company Name	Location	Business Content	Established	Capital	Aozora Bank's Share-holding	Group Share-holding
Aozora Trust Bank, Ltd.	3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo	Trust services, banking operations	February 28, 1994	5,000	100.00	—
AOZORA Loan Services Co., Ltd.	13-5, Kudan-kita 1-chome, Chiyoda-ku, Tokyo	Distressed loan servicing	June 18, 1996	500	67.60	—
Aozora Card Co., Ltd.	3-4, Nibancho, Chiyoda-ku, Tokyo	Card loan services	December 6, 2001	1,000	60.00	—
Aozora Investment Co., Ltd.	3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo	Venture capital investment	May 17, 1991	20	100.00	—
Aozora Business Service Co., Ltd.	3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo	Administrative temporary staff services	September 21, 1987	10	100.00	—
Aozora Information Systems Co., Ltd.	8-15, Hyakunincho 2-chome, Shinjuku-ku, Tokyo	Systems development	April 1, 1967	150	100.00	—
AOZORA SOFTWARE CORPORATION	8-15, Hyakunincho 2-chome, Shinjuku-ku, Tokyo	Systems development	May 9, 1973	12	—	100.00
Aozora Computer Co., Ltd.	21, Nikkocho 1-chome, Fuchu-shi, Tokyo	Computer operation	April 1, 1991	20	5.00	95.00
The Nippon Credit Bank (Curacao) Capital, N.V. (in liquidation)	Curacao, The Netherlands Antilles	In liquidation	August 6, 1996	20	100.00	—

Directors and Auditors
(As of June 26, 2003)

DIRECTORS

Chairman
Kazuhiko Kasai
Director,
SOFTBANK CORP.

President and CEO
Hiroshi Maruyama

Senior Managing Director
Fudeji Hama

Senior Managing Director
Kenji Kajiwara

Director
Yuji Inagaki

Director
Izumi Ogura

Director
Masayoshi Son
President & CEO,
SOFTBANK CORP.

Director
Yoshihiko Miyauchi
Chairman and Chief Executive Officer,
ORIX Corporation

Director
Koukei Higuchi
Counsellor,
The Tokio Marine
and Fire Insurance Co., Ltd.

Director
James Danforth Quayle
Former Vice President of the United States of America

Director
Fumikatsu Tokiwa
Former Chairman and
Representative Director,
Kao Corporation

Director
Edward G. Harshfield
Chairman and Director,
Saxon Capital Corporation

AUDITORS

Standing Auditor
Ken Shigihara

Auditor
Koichi Hori
President and Representative Director,
Dream Incubator Inc.

Auditor
Takashi Ejiri
Senior Partner,
Asahi Koma Law Offices

Auditor
Alan S. Waldenberg
Partner and Member of Executive Committee,
SCHULTE ROTH & ZABEL LIP

EXECUTIVE OFFICERS

Chief Executive Officer
Hiroshi Maruyama

Senior Executive Officer
Fudeji Hama

Senior Executive Officer
Kenji Kajiwara

Managing Executive Officer
Yuji Inagaki

Managing Executive Officer
Izumi Ogura

Managing Executive Officer
Tomoaki Ishii

Managing Executive Officer
Shiro Nagaki

Managing Executive Officer
Yoshiyuki Kurihara

Managing Executive Officer
Norimichi Kurakake

Executive Officer
Ryoichi Kawai

Executive Officer
Tadaaki Satoyoshi

Executive Officer
Tetsuo Ninomiya

Executive Officer
Yukimichi Nakatani

Executive Officer
Hirokazu Takino

Executive Officer
Katsutoshi Ishida

Executive Officer
Akira Takami

Executive Officer
Takayoshi Morikawa

AOZORA BANK, LTD.

3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo 102- 8660, Japan
Phone: 03-3263-1111
URL http://www.aozorabank.co.jp/

Forward-Looking Statements
This annual report contains forward-looking statements regarding the Bank's financial condition and results of operations. These forward-looking statements, which include the Bank's views and assumptions with respect to future events, involve certain risks and uncertainties. Actual results may differ from forecasts due to changes in economic conditions.

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Investors Relations Department,
Corporate Planning Division,
Aozora Bank, Ltd.

AOZORA BANK, LTD.

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