

Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion should be read in conjunction with our consolidated and non-consolidated financial statements prepared in accordance with accounting principles generally accepted in Japan ("Japanese GAAP") for banks, including the notes to those financial statements, included elsewhere in this annual report. Except as otherwise indicated, the financial information in the following discussion is based on our consolidated financial statements.

The discussion below contains forward-looking statements regarding the intent, belief or current expectations of management with respect to our financial condition and future results of operations. In many cases, but not all, we use such words as "anticipate," "believe," "estimate," "expect," "intend," "plan," "probability," "risk" and similar expressions in relation to us or our management to identify forward-looking statements. These statements reflect our current views with respect to future events and are subject to risks, uncertainties and assumptions. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results may vary materially from those we currently anticipate or aim at. We do not intend to update these forward-looking statements.

In this section, except where the context indicates otherwise, "we" or "our" means Shinsei Bank, Limited and its subsidiaries and affiliates accounted for by the equity method, and "Shinsei" or "the Bank" refers to Shinsei Bank alone.

Financial and operational data that are stated in multiples of ¥0.1 billion have been truncated. All percentages have been rounded to the nearest 0.1%.

"Fiscal year 2005" refers to our fiscal year ended March 31, 2006, and other fiscal years are referred to similarly.

Overview

Shinsei Bank, Limited is a leading diversified financial institution operating principally in Japan. Guided by global standards of management and governance, we are bringing innovative banking practices to the Japanese market with a business model based on three strategic pillars: Institutional Banking, Consumer and Commercial Finance (CCF) and Retail Banking. These three pillars cover a broad range of businesses and customer segments which provide us with diversified revenues. In particular, our acquisitions of APLUS Co., Ltd., in September 2004 and Showa Leasing Co., Ltd., in March 2005 substantially expanded our CCF operations. We believe our unique history and business strategy have made us more global than local financial institutions in Japan and more local than foreign financial institutions having a presence in Japan.

Our focus is to grow repeatable, customer-driven revenues by meeting our customers' needs. We recently have made significant progress in diversifying our revenue sources, increasing the contribution of non-interest income and deploying excess capital in value-enhancing opportunities. In fiscal year 2005, we were able to:

- continue to implement our "solution banking" approach in our institutional banking business, bringing investment banking services and expertise to our traditional customer base while also targeting new clients through close collaboration among our product specialists and relationship managers;
- expand our retail banking business by introducing products tailored to customers' needs and delivering them through cost-effective means such as our remote channels and our "*BankSpot*" mini-branches;

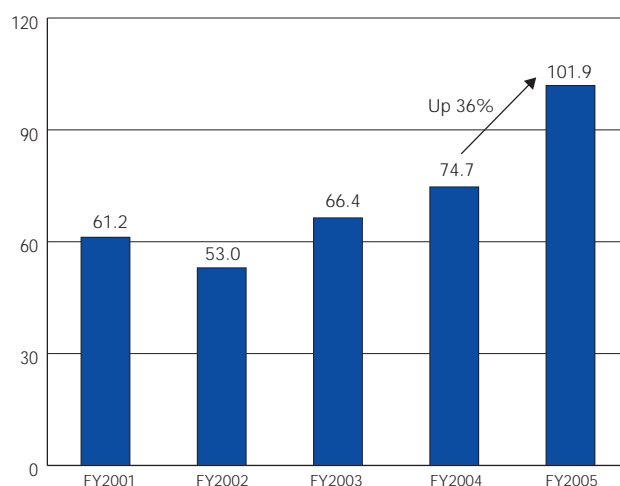
- enhance the efficiency and profitability of our CCF businesses, including APLUS and Showa Leasing, through the application of our financial and risk management expertise, improved product offerings and reduced funding costs; and
- maintain our fiscal discipline in order to further improve returns on invested capital, minimize non-performing loans and continue to rationalize expenses.

Fiscal Year 2005 Financial Highlights

(All figures compared to fiscal year 2004)

- Revenue growth of ¥95.5 billion or 53.8% to ¥273.4 billion
- Net income of ¥76.0 billion, up 12.8%
- Cash basis net income of ¥101.9 billion, up 36.4%
- Expense-to-revenue ratio improved from 54.7% to 50.0%
- Return on equity (fully diluted) of 9.3%
- Return on tangible equity of 18.8%
- Fully diluted net income per share on cash basis of ¥50.55
- Total capital adequacy ratio improved from 11.8% to 15.5%

**Cash Basis⁽¹⁾⁽²⁾ Net Income Milestone Achieved:
Net Income of ¥101.9 Billion in Fiscal Year (FY) 2005**
(Billions of yen)



Notes:

(1) Excludes amortization of APLUS and Showa Leasing's consolidation goodwill and other intangibles, net of tax benefit. Japanese GAAP basis net income in FY2004 was ¥67.4 billion and in FY2005 was ¥76.0 billion.

(2) From FY2001 to FY2003 cash basis net income is assumed to be equal to Japanese GAAP basis net income.

Outlook

We believe we have established a strong foundation for future growth based on:

- our highly-experienced, responsive management team;

Significant Events

Offering of Preferred Securities and Subordinated Notes

On February 23, 2006, we successfully completed dual tranche hybrid Tier I and lower Tier II global institutional offerings. We issued \$775.0 million of step-up non-cumulative perpetual preferred securities (treated as hybrid Tier I) and €1.0 billion of step-up callable subordinated notes. The initial dividend on the preferred securities is 6.418%. The step-up callable subordinated notes bear interest at a fixed rate of 3.75% for five years. Having strengthened our capital base through these issuances,

- our global-standard corporate governance structure, led by a board of directors that is composed principally of leading Japanese and foreign industry and academic leaders;
- our client-focused corporate culture in which employee compensation and promotion is performance-based, which makes us an attractive “employer of choice” among Japanese financial institutions;
- the scope and synergies of our innovative three-pillar business model consisting of Institutional Banking, CCF and Retail Banking;
- our high asset quality, strong capital base and enhanced revenue base;
- our strong household recognition, making us one of the best recognized brands among Japanese banks; and
- the transformation of our information systems from a mainframe-based architecture to a flexible, modular design utilizing primarily off-the-shelf hardware and software and the internet to offer real-time functionality to our staff and customers.

While many Japanese financial institutions have expressed the need for wide-ranging changes to their corporate strategy, business model and operations, we believe that our rapid pace of implementing strategic and operational changes sets us apart and places us in a strong competitive position.

we intend to repay approximately ¥117.0 billion of our outstanding Upper Tier II subordinated debt and bonds by September 2006. On March 23, 2006, we completed an additional hybrid non-step-up Tier I global institutional offering. We issued \$700.0 million of non-cumulative non-step-up perpetual preferred securities. The initial dividend on the non-step-up perpetual preferred securities is 7.16%. These issuances and intended debt repayments are consistent with our strategy to strengthen our capital ratios in a cost-effective manner.

February 23, 2006 Offering

Hybrid Tier I

Structure	Perpetual Non-Call 10 year
Issue amount	\$775.0 million
Ratings (Moody's/S&P)	Baa2/BBB-

Lower Tier II

Structure	10 Year Non-Call 5 year
Issue amount	€1.0 billion
Ratings (Moody's/S&P)	Baa1/BBB

March 23, 2006 Offering

Hybrid Tier I

Structure	Perpetual Non-Call 10 year
Issue amount	\$700.0 million
Ratings (Moody's/S&P/Fitch)	Baa2/BBB-/BBB-

Acquisition of APLUS and Related Transactions

On September 29, 2004, we acquired a controlling interest in APLUS, a consumer credit company in Japan. APLUS provides a number of consumer financing products including installment sales credit, credit cards, loan cards, loan guarantees and billing settlement services.

Under Japanese GAAP, APLUS's results of operations for the six months ended September 30, 2004 had no effect on our consolidated income statement for the same period because APLUS became our consolidated subsidiary at the end of the period. Following our investment in APLUS, we conducted a fair value review of APLUS's assets and liabilities, and also conducted a fair value review of its intangible assets for purposes of preparing our consolidated balance sheet as of September 30, 2004. The excess of our purchase price over the net asset fair value after deducting identified intangible assets and their associated deferred tax liability was accounted for as consolidation (acquired) goodwill. As a result, ¥201.7 billion in consolidation goodwill and ¥70.2 billion in intangible assets were recorded in our consolidated financial statements.

Although approximately 36% of APLUS's common stock is held by minority shareholders, none of APLUS's income will be attributed to minority shareholders until such time as APLUS's cumulative net income subsequent to September 30, 2004, less dividends on preferred stock paid to shareholders other than us, exceeds the aggregate amount of our investment in the preferred stock of APLUS.

On March 24, 2006, APLUS invested ¥10.5 billion in purchasing 2.1 million shares, and owns 97.29%, of Zen-Nichi Shinpan Co., Ltd., an installment sales company. Under Japanese GAAP, March 31, 2006 was deemed as the acquisition date of our controlling interest in Zen-Nichi Shinpan and therefore the results of Zen-Nichi Shinpan are not reflected in our or APLUS's consolidated statement of income for the year then ended.

Acquisition of Showa Leasing

On March 23, 2005, we acquired a 96.3% interest in Showa Leasing, a leading general and automobile leasing company in Japan.

Under Japanese GAAP, March 31, 2005 was deemed as the acquisition date of our controlling interest in Showa Leasing and therefore the results of Showa Leasing are not reflected in our consolidated statement of income for the year then ended. In the consolidation of Showa Leasing into our consolidated balance sheet as of March 31, 2005, the consolidated assets and liabilities of Showa Leasing were stated at their fair values. As a result, ¥51.2 billion in consolidation goodwill and ¥10.1 billion in intangible assets were recorded in our consolidated financial statements.

Conversion from a Long-Term Credit Bank to an Ordinary Bank

We converted our long-term credit bank charter to an ordinary bank charter on April 1, 2004. We believe that operating as an ordinary bank has eliminated several restrictions applicable to long-term credit banks and not applicable to ordinary banks, thereby improving our competitiveness. In particular, we believe that we are able to more freely accept deposits from customers without having to offer them debentures. Converting to an ordinary bank has also enabled us to extend long-term loans to customers, including retail customers, without having to comply with special rules concerning loan security and repayment terms that are applicable only to long-term credit banks, giving us greater flexibility to execute our retail banking strategy in recent periods.

The Financial Services Agency (FSA) allowed us to retain the ability to issue debentures without registration, which is one of the benefits that we enjoyed as a long-term credit bank, for a period of ten years following conversion until March 2014.

Reduction in Non-Performing Claims and Expiration of Cancellation Right to the DIC

Following the sale of our common shares by the Japanese government to private investors in March 2000, our management accorded the highest priority to improving the quality of our loan portfolio. We reduced our balance of non-performing claims from ¥1,864.7 billion as of March 31, 2000 to ¥42.5 billion as of March 31, 2006. Over that period, we disposed of ¥1,822.2 billion of non-performing claims, including ¥9.2 billion in the fiscal year ended March 31, 2006. We made the disposals through sales, collections and write-offs, as well as the return of claims to the Deposit Insurance Corporation of Japan (DIC), under the terms of the original share purchase agreement.

Approximately 58% of the non-performing claims we disposed of were returned to and accepted by the DIC under the cancellation right. The right expired on March 1, 2003, and all disputes regarding exercise of the right with the DIC were resolved in the fiscal year ended March 31, 2005.

Global Settlement of Claims Relating to EIE International

On May 23, 2004, we entered into a global settlement with the bankruptcy trustee for EIE International Corporation, a real estate developer, and other parties with respect to disputes arising from lending to EIE International by our predecessor, LTCB. This resulted in part from the trustee moving to reinstate litigation in Saipan that had initially been filed in July 2001. Under the terms of the settlement, we paid the trustee ¥21.8 billion on June 16, 2004. The DIC, in connection with the sale to private investors of our shares under the original share purchase agreement, agreed to indemnify us for losses arising from legal proceedings brought after March 1, 2000 relating to the conduct of LTCB prior to that date. On December 27, 2004, we sought

indemnity from the DIC for approximately ¥15.0 billion in connection with this litigation as well as other indemnifiable claims, after taking into account the ¥5.0 billion threshold amount and other factors according to the share purchase agreement. The ¥15.0 billion reflects in large part a claim for ¥17.4 billion of the amount paid in the EIE settlement. On April 28, 2005, the DIC notified us that our indemnification claim includes both indemnifiable amounts as well as unindemnifiable amounts and unless the unindemnifiable amounts are clearly separated, the DIC will not accept our claim. We provided ¥4.5 billion in specific reserves for other credit losses related to this dispute in the fiscal year ended March 31, 2005 and on July 19, 2005 we filed a lawsuit in the Tokyo District Court against the DIC for an indemnity of approximately ¥13.4 billion in respect of EIE settlement losses. This lawsuit is pending.

Sales of Japanese Equities

Pursuant to the share purchase agreement, we transferred to the DIC LTCB's portfolio of approximately ¥2.3 trillion in Japanese equities, comprising mainly listed shares, based on the market value of the securities as of January 2000. The DIC also entrusted these shares to our trust bank subsidiary for a period of five years and granted us an ongoing option to repurchase any of them. We have recorded net gains from the exercise of the call option, within other business income or losses, as a component of income on monetary assets held in trust. The five-year option period expired in March 2005, although refusals on the part of the DIC to sell particular shares resulted in a one-year extension with respect to such shares from the date of refusal in accordance with the share purchase agreement. We will no longer have any repurchase option rights in future periods.

Stock Options

At our annual general meeting of shareholders on June 24, 2005, we obtained approval for the issuance of stock acquisition rights as stock options to directors, statutory executive officers (shikkou-yaku) and employees of Shinsei as well as directors and employees of its wholly owned subsidiaries. Up to 24,000 stock acquisition rights, each representing the right to acquire 1,000 common shares may be allocated in the aggregate under this approval. Between June 27, 2005 and May 25, 2006, we issued 20,042 of the stock acquisition rights; 9,626 of which have an exercise price of ¥601 per share of common stock, 210 of which have an exercise price of ¥697.67 of which have an exercise price of ¥774 and 10,139 of which have an exercise price of ¥825. The exercise period of the stock acquisition rights is from July 1, 2005 to June 23, 2015 for 3,417 of the issued options, from July 1, 2007 to June 23, 2015 for 6,486 of the issued options and from June 1, 2006 to June 23, 2015 for 3,358 of the issued options and from June 1, 2008 to June 23, 2015 for the other 6,781 issued options. In addition, we have issued an aggregate of 9,891 options in prior periods exercisable from July 1, 2006 to June 23, 2014 with exercise prices ranging from ¥551 to ¥697 per share.

Acquisition of Treasury Shares

In order to implement the stock option plan described above, we will seek approval at our annual general meeting of shareholders on June 27, 2006 to repurchase up to 30 million shares of our common stock for a maximum aggregate acquisition price of ¥30 billion. This approval, if granted, will be valid for one year. Our articles of incorporation also permit our board of directors to authorize the repurchase of shares from time to time pursuant to the applicable provisions of the Corporation Act. Pursuant to the prior year's repurchase authorization, we have acquired 4,019,000 shares of common stock for an aggregate amount of ¥2,997.8 million as of June 6, 2006. In addition, we have acquired 11,403 shares of common stock from shareholders holding less than one unit, or 1,000 shares, of our common stock for an aggregate of ¥7.7 million as of June 6, 2006.

Recent Developments

Administrative Action on Shinsei Trust and Banking

On April 26, 2006, Shinsei Trust and Banking (STB) was asked by the FSA to suspend operations relating to new business associated with the real estate trust business for one year. The business suspension order cited a failure to investigate or assess properties adequately prior to real estate entrustment and related compliance and governance issues. We take this matter seriously and are taking definitive action to strengthen our corporate governance and internal compliance procedures to prevent any re-occurrence.

STB's existing businesses, including management of already entrusted properties, non-real estate related entrustment businesses and our private client business, will not be affected by this suspension.

Strategic Investment in Jih Sun Financial Holding of Taiwan

On May 10, 2006, we announced our agreement to acquire 31.8% of the common and preferred shares of Jih Sun Financial Holding for approximately ¥40.2 billion. Jih Sun is a financial holding company with subsidiaries offering a full array of banking and brokerage products and services in Taiwan. We expect our contribution of investment and expertise to help Jih Sun to strengthen its capital base and expand its operations and expect Jih Sun to be treated as our equity-method affiliate. As of March 31, 2006, Jih Sun had total consolidated assets of NT\$345.7 billion.

Selected Financial Data (Consolidated)

Shinsei Bank, Limited, and Consolidated Subsidiaries
As of or for the fiscal years ended March 31, 2006, 2005, 2004, 2003 and 2002

	Billions of yen (except per share data and percentages)				
	2006	2005	2004	2003	2002
Income statement data:					
Net interest income	¥ 82.2	¥ 66.8	¥ 57.1	¥ 66.1	¥ 88.4
Net fees and commissions	45.4	32.4	18.5	16.5	7.8
Net trading income	27.5	23.9	2.7	8.5	1.7
Net other business income	118.0	54.5	45.0	16.5	22.4
Total revenue	273.4	177.8	123.5	107.7	120.4
Total general and administrative expenses	136.5	97.3	70.1	69.7	69.5
Net credit costs (recoveries)	30.1	(0.9)	(15.4)	(8.6)	1.0
Amortization of consolidation goodwill and other intangibles	29.4	8.8	0.0	—	0.6
Other (losses) gains, net	(3.4)	(7.0)	0.1	(0.2)	(8.8)
Income before income taxes and minority interests	73.7	65.5	68.9	46.3	40.3
Current income tax	3.7	1.4	1.4	0.8	0.3
Deferred income tax (benefit)	(11.4)	(3.4)	1.1	(7.5)	(21.2)
Minority interests in net income (loss) of subsidiaries	5.2	0.1	(0.0)	0.0	0.0
Net income	¥ 76.0	¥ 67.4	¥ 66.4	¥ 53.0	¥ 61.2
Balance sheet data:					
Trading assets	¥ 193.5	¥ 168.5	¥ 635.0	¥ 361.1	¥ 443.9
Securities	1,494.4	1,478.2	1,483.2	1,770.9	1,462.2
Loans and bills discounted	4,087.5	3,430.4	3,047.0	3,502.3	4,801.9
Customers' liabilities for acceptances and guarantees	813.4	1,058.1	38.3	50.5	114.4
Reserve for credit losses	(144.8)	(149.7)	(177.9)	(216.5)	(370.0)
Total assets	9,405.0	8,576.3	6,343.7	6,706.9	8,069.5
Deposits, including negotiable certificates of deposit	4,071.7	3,452.8	2,734.4	2,576.9	2,260.7
Debentures	1,018.9	1,242.6	1,358.0	1,884.3	2,730.4
Trading liabilities	149.9	69.1	92.2	117.4	173.5
Borrowed money	1,205.7	1,160.2	334.4	336.8	459.2
Acceptances and guarantees	813.4	1,058.1	38.3	50.5	114.4
Total liabilities	8,287.8	7,735.7	5,612.7	6,026.9	7,445.9
Minority interests in subsidiaries	261.8	53.8	0.9	0.1	0.0
Capital stock	451.2	451.2	451.2	451.2	451.2
Total shareholders' equity	855.3	786.6	730.0	679.8	623.5
Total liabilities, minority interests in subsidiaries and shareholders' equity	9,405.0	8,576.3	6,343.7	6,706.9	8,069.5
Per share data (in yen⁽¹⁾):					
Common shareholders' equity	¥ 380.20	¥ 329.65	¥ 287.94	¥ 249.59	¥ 211.00
Fully diluted shareholders' equity ⁽²⁾	421.62	390.06	378.70	335.28	307.51
Basic net income	53.16	46.78	46.03	36.18	42.21
Diluted net income	37.75	34.98	32.75	26.15	30.19
Capital adequacy data:					
Tier I capital ratio	10.3%	7.0%	16.2%	14.3%	10.7%
Total capital adequacy ratio	15.5%	11.8%	21.1%	20.1%	17.0%
Average balance data:					
Securities	¥1,721.4	¥1,509.4	¥1,618.1	¥1,988.3	¥1,947.1
Loans and bills discounted	3,730.7	3,099.9	3,124.0	4,009.6	5,512.4
Total assets	8,990.6	7,460.0	6,525.3	7,388.2	8,777.6
Interest-bearing liabilities	6,418.3	5,216.0	4,879.8	6,313.1	7,066.9
Total liabilities and minority interests in subsidiaries	8,169.6	6,701.7	5,820.4	6,736.6	8,174.5
Shareholders' equity	821.0	758.3	704.9	651.6	603.1
Other data:					
Return on assets	0.8%	0.9%	1.0%	0.7%	0.7%
Return on equity (fully diluted)	9.3%	8.9%	9.4%	8.1%	10.2%
Ratio of equity to total assets	9.1%	10.2%	10.8%	8.8%	6.9%
Ratio of deposits, including negotiable certificates of deposit, to total liabilities	49.1%	44.6%	48.7%	42.8%	30.4%
Net interest margin	1.4%	1.3%	1.1%	1.0%	1.1%
Expense-to-revenue ratio	50.0%	54.7%	56.8%	64.7%	57.7%
Non-performing claims, non-consolidated	¥42.5	¥51.7	¥97.3	¥233.2	¥1,113.6
Ratio of non-performing claims to total claims, non-consolidated	1.0%	1.4%	2.8%	5.7%	20.0%
Net deferred tax assets	¥16.3	¥4.3	¥22.8	¥18.4	¥17.6
Net deferred tax assets as a percentage of Tier I capital	2.2%	0.9%	3.2%	2.8%	2.9%

Notes:

(1) On June 25, 2003, Shinsei's common shareholders approved a 1-for-2 reverse stock split, which was consummated on July 29, 2003. The per share data is presented as if the reverse stock split had been consummated at the beginning of the periods presented.

(2) Fully diluted shareholders' equity per share is calculated by dividing total shareholders' equity at the end of the periods presented by the number of common shares that would have been outstanding had all securities convertible into or exercisable for common shares been converted or exercised with an applicable conversion or exercise price within the predetermined range at the end of the period.

We recorded amortization of consolidation (acquired) goodwill and other intangibles, net of tax benefit, of ¥25.8 billion associated with the acquisitions, of APLUS and Showa Leasing in the fiscal year ended March 31, 2006. To provide greater transparency and understanding of our underlying performance, we disclose cash basis net income, which excludes the amortization of consolidation goodwill

and other intangibles, net of tax benefit, in our earnings announcements. Our cash basis net income for the fiscal year ended March 31, 2006 was ¥101.9 billion, an increase of 36.4% compared to cash basis net income of ¥74.7 billion for the prior year. A reconciliation of various earnings measures from our results reported under Japanese GAAP to a cash basis is given below.

Supplemental Financial Data and Reconciliations to Japanese GAAP Measures
Shinsei Bank, Limited, and Consolidated Subsidiaries

For the fiscal year ended March 31, 2006	Billions of yen (except per share data and percentages)
Amortization of consolidation goodwill and other intangibles	
Amortization of intangible assets	¥ 9.0
Associated deferred tax liability	(3.6)
Amortization of consolidation goodwill	20.4
Total amortization of consolidation goodwill and other intangibles, net of tax benefit	25.8
Reconciliation of net income to cash basis net income	
Net income	76.0
Amortization of consolidation goodwill and other intangibles, net of tax benefit	25.8
Cash basis net income	101.9
Reconciliation of basic net income per share to cash basis basic net income per share	
Basic net income per share	53.16
Effect of amortization of consolidation goodwill and other intangibles, net of tax benefit	19.00
Cash basis basic net income per share	72.16
Reconciliation of fully diluted net income per share to cash basis fully diluted net income per share	
Fully diluted net income per share	37.75
Effect of amortization of consolidation goodwill and other intangibles, net of tax benefit	12.80
Cash basis fully diluted net income per share	50.55
Reconciliation of return on assets to cash basis return on assets	
Return on assets	0.8%
Effect of amortization of consolidation goodwill and other intangibles, net of tax benefit	0.3
Cash basis return on assets	1.2
Reconciliation of return on equity to cash basis return on equity	
Return on equity (fully diluted)	9.3%
Effect of amortization of consolidation goodwill and other intangibles, net of tax benefit	3.1
Cash basis return on equity (fully diluted)	12.4
Reconciliation of return on equity to return on tangible equity	
Return on equity (fully diluted)	9.3%
Effect of consolidation goodwill and other intangibles ⁽¹⁾	9.5
Return on tangible equity (fully diluted)	18.8

Note:

(1) Net income excludes amortization of consolidation (acquired) goodwill and other intangibles, net of tax benefit. Average shareholders' equity excludes consolidation (acquired) goodwill and other intangibles, net of associated deferred tax liability.

Results of Operations

Fiscal Year Ended March 31, 2006 Compared with Fiscal Year Ended March 31, 2005

The results of both APLUS and Showa Leasing are included in our consolidated income statement for the full year ended March 31, 2006. On a combined basis, they contributed ¥107.9 billion to our total consolidated revenue. The results of Showa Leasing are not included in our consolidated income statement for the prior year, while six months of APLUS's results are included. For the fiscal year ended March 31, 2005, APLUS contributed ¥36.2 billion to our total revenue.

Total revenue for the fiscal year ended March 31, 2006 was ¥273.4 billion, an increase of ¥95.5 billion or 53.8% as compared to the previous fiscal year. Both net interest income and non-interest income contributed to this significant increase in revenue. Revenue contribution from fees and commissions, trading and other non-interest revenue sources (including income on leased assets and installment receivables) grew to 69.9% of total revenue in fiscal year 2005.

Our total general and administrative expenses for the fiscal year ended March 31, 2006 were ¥136.5 billion, an increase of ¥39.2 billion or 40.4% as compared to the previous fiscal year. The increase is largely due to the inclusion of Showa Leasing and the full year impact of APLUS. This increase in expenses was partly offset by continued expense

rationalization across all businesses. As a result, for the fiscal year ended March 31, 2006, our ratio of total general and administrative expenses to total revenue improved from 54.7 % to 50.0%.

We recorded net credit costs of ¥30.1 billion during fiscal year 2005, as compared to net credit recoveries of ¥0.9 billion for the previous fiscal year. The increase in credit costs in this fiscal year was largely attributable to the full year impact of APLUS and inclusion of Showa Leasing. The net credit recoveries in last fiscal year were primarily attributable to a reduction in Shinsei's historical default ratio due to improvement in overall asset quality. This was partly offset by APLUS's credit costs in the second half of last fiscal year.

We further reduced our non-performing loans (NPLs) balance under the Financial Revitalization Law so that as of March 31, 2006, total NPLs of Shinsei were ¥42.5 billion, a decline of ¥9.2 billion or 17.9% as compared to the balance at March 31, 2005. NPLs were 1.0% of total claims outstanding at March 31, 2006 on a non-consolidated basis.

Our Tier I capital ratio of 10.3% and a total capital adequacy ratio of 15.5% as of March 31, 2006, reflect consistent profitability. Our capital mostly consists of Tier I capital and as of March 31, 2006, net deferred tax assets, the difference between our deferred tax assets and deferred tax liabilities, constituted 2.2% of our Tier I capital.

Table 1. Interest-Earning Assets and Interest-Bearing Liabilities (Consolidated)

Fiscal years ended March 31	Billions of yen (except percentages)					
	2006			2005 ⁽³⁾		
	Average balance	Interest	Yield/rate	Average balance	Interest	Yield/rate
Interest-earning assets:						
Loans and bills discounted	¥3,730.7	¥104.4	2.80%	¥3,099.9	¥ 77.3	2.50%
Leased assets and installment receivables	793.7	46.0	5.80	152.2	10.1	6.64
Securities	1,721.4	16.8	0.98	1,509.4	15.8	1.05
Other interest-earning assets ⁽¹⁾	503.7	3.7	0.74	553.4	8.1	1.48
Total revenue on interest-earning assets	¥6,749.7	¥171.0	2.53%	¥5,315.0	¥111.4	2.10%
Interest-bearing liabilities:						
Deposits, including negotiable certificates of deposit	¥3,776.8	¥ 16.9	0.45%	¥3,096.2	¥ 13.6	0.44%
Debentures	1,152.9	4.7	0.41	1,311.4	6.1	0.47
Subordinated debt	259.7	5.5	2.13	210.5	6.9	3.32
Borrowed money and corporate bonds	999.3	12.2	1.22	338.0	6.6	1.96
Other interest-bearing liabilities ⁽¹⁾	229.4	3.3	1.45	259.7	1.0	0.40
Total expense on interest-bearing liabilities	¥6,418.3	¥ 42.7	0.67%	¥5,216.0	¥ 34.4	0.66%
Non-interest-bearing sources of funds:						
Non-interest-bearing (assets) liabilities, net	¥ (489.6)	—	—	¥ (659.2)	—	—
Shareholders' equity ⁽²⁾	821.0	—	—	758.3	—	—
Total interest-bearing liabilities and non-interest-bearing sources of funds	¥6,749.7	—	—	¥5,315.0	—	—
Net interest margin	—	—	1.87%	—	—	1.44%
Impact of non-interest-bearing sources	—	—	0.03	—	—	0.01
Net revenue on interest-earning assets/yield on interest-earning assets	—	¥128.3	1.90%	—	¥ 77.0	1.45%
Reconciliation of total revenue on interest-earning assets to total interest income						
Total revenue on interest-earning assets	¥6,749.7	¥171.0	2.53%	¥5,315.0	¥111.4	2.10%
Less: Income on leased assets and installment receivables	793.7	46.0	5.80	152.2	10.1	6.64
Total interest income	¥5,955.9	¥125.0	2.10%	¥5,162.8	¥101.3	1.96%
Total interest expenses	—	42.7	—	—	34.4	—
Net interest income	—	¥ 82.2	—	—	¥ 66.8	—

Notes:

(1) Other interest-earning assets and other interest-bearing liabilities include interest swaps and fund swaps.

(2) Represents a simple average of the balance at the end of the current period and the balance at the end of the previous period.

(3) Prior period reporting has been restated to be consistent with current reporting format.

Table 2. Analysis of Changes in Net Revenue on Interest-Earning Assets (Consolidated)

From fiscal year ended March 31, 2005 to fiscal year ended March 31, 2006	Billions of yen		
	Due to change in ⁽¹⁾		
	Volume	Rate	Net change
Increase (decrease) in interest revenue:			
Loans and bills discounted	¥15.7	¥11.3	¥27.0
Leased assets and installment receivables	42.5	(6.6)	35.9
Securities	2.2	(1.2)	1.0
Other interest-earning assets	(0.7)	(3.7)	(4.4)
Total revenue on interest-earning assets			¥59.5
Increase (decrease) in interest expenses:			
Deposit, including negotiable certificates of deposit	¥ 3.0	¥ 0.2	¥ 3.2
Debentures	(0.7)	(0.7)	(1.4)
Subordinated debt	1.6	(3.1)	(1.4)
Borrowed money and corporate bonds	12.9	(7.3)	5.6
Other interest-bearing liabilities	(0.1)	2.4	2.3
Total expense on interest-bearing liabilities			¥ 8.2
Net increase in net revenue on interest-earning assets			¥51.3

Reconciliation of total revenue on interest-earning assets to total interest income

Total revenue on interest-earning assets	¥59.5
Less: Income on leased assets and installment receivables	35.9
Total interest income	¥23.6
Total interest expenses	¥ 8.2
Net increase in net interest income	¥15.3

Note:

(1) The changes in interest income and expense for each category are divided into the portion of change attributable to the variance in volume or rate for that category. The attribution of the volume variance is calculated by multiplying the change in volume by the previous year's rate. The attribution of the rate variance is calculated by multiplying the change in rate by the current year's balance.

Net Revenue on Interest-Earning Assets

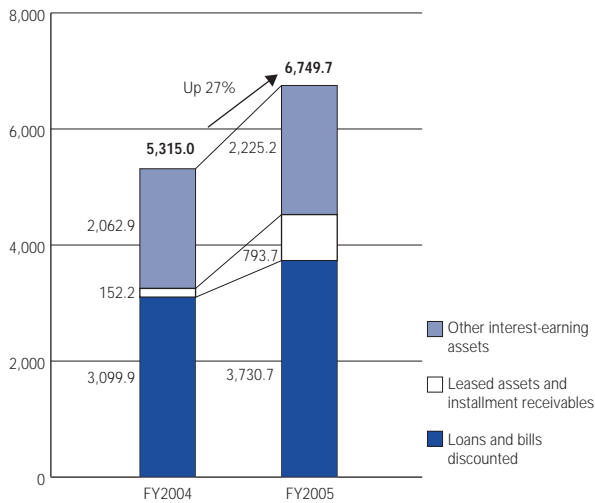
Our net revenue on interest-earning assets includes net interest income as well as revenue earned on our average balance of leased assets and installment receivables. We consider income on leased assets and installment receivables to be a component of our interest income, but Japanese GAAP does not include income on leased assets and installment receivables in net interest income. Thus we calculate net interest income excluding income on leased assets and installment receivables and then reconcile to net revenue on interest-earning assets by including income on leased assets and installment receivables, which is reported in net other business income in our consolidated statement of income.

Our principal interest-earning assets include loans and bills discounted, securities (other than securities held for trading purposes), consisting mainly of Japanese government bonds and bonds issued by non-Japanese corporations, as well as leased assets and installment receivables generated in our CCF business. Our principal interest-bearing liabilities are deposits (including negotiable certificates of deposit and foreign currency deposits), debentures, subsidiaries' borrowings from other financial institutions, and subordinated bonds and debt.

Strong Growth in Interest-Earning Assets and Yields

Average Balance of Interest-Earning Assets

(Billions of yen)



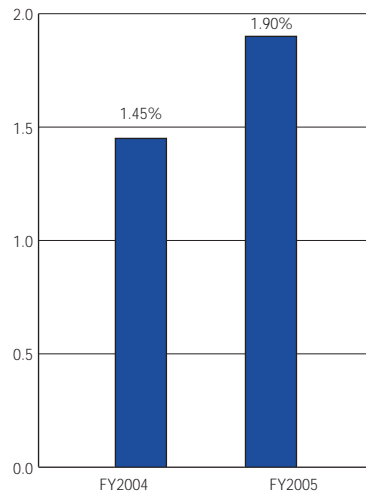
Net revenue on interest-earning assets for the fiscal year ended March 31, 2006 was ¥128.3 billion, an increase of ¥51.3 billion compared with the prior fiscal year. Total revenue on interest-earning assets increased by ¥59.5 billion while total interest expenses increased by ¥8.2 billion. The net yield on interest-earning assets increased to 1.90%, an increase of 0.45% compared with the prior fiscal year.

Based on an attribution analysis which divides revenue and expense changes into either a variance in the volume of assets or liabilities or a variance in interest rate, the ¥59.5 billion increase in total revenue on interest-earning assets is attributable primarily to higher volume of leased assets and installment receivables of APLUS and Showa Leasing following their consolidation and an increase in balance and yield on loans and bills discounted. The average consolidated balance for loans and bills discounted increased to ¥3,730.7 billion for the fiscal year ended March 31, 2006 from ¥3,099.9 billion for the previous fiscal year. The average yield increased to 2.80% for the fiscal year ended March 31, 2006 from 2.50% for the previous fiscal year. The increases in average balance and yield were primarily the result of increases in institutional loan balances and yields together with an increase in consumer finance loan balances originated by APLUS and increased retail loan balances.

The ¥8.2 billion increase in total interest expense was attributable primarily to the increased average balances of borrowed money and corporate bonds and increased average balances of deposits and negotiable certificates of deposit

Net Yield on Interest-Earning Assets

(%)



(NCD). The increase in borrowed money and corporate bonds interest expense was due entirely to an increase in the average balance outstanding to ¥999.3 billion for the fiscal year ended March 31, 2006 from ¥338.0 billion for the previous fiscal year mainly due to increases in borrowed money attributable to APLUS and Showa Leasing. A reduction in the average interest rate on borrowed money and corporate bonds of 0.73% to 1.22% for the fiscal year ended March 31, 2006, from 1.96% for the previous fiscal year reflects our continuing efforts to reduce borrowing costs in APLUS and Showa Leasing. This reduction partially offset the increase in interest expense arising from the higher average balance outstanding. The increase in deposits and NCD interest expense came primarily from an increase in the average balance outstanding to ¥3,776.8 billion for the fiscal year ended March 31, 2006 from ¥3,096.2 billion for the previous fiscal year. The average rate paid on subordinated debt decreased to 2.13% for the fiscal year ended March 31, 2006, from 3.32% for the previous fiscal year, a decline of 1.20%. The decline in subordinated debt interest expense is consistent with our strategy to call and replace high cost subordinated debt with lower cost subordinated debt. A decline in the average debentures balance outstanding to ¥1,152.9 billion for the fiscal year ended March 31, 2006 from ¥1,311.4 billion for the previous fiscal year was consistent with our strategy of increasing retail deposits and reducing maturing debentures that were issued in a higher interest rate environment.

Net Fees and Commissions

Fees and commissions primarily include fees on non-recourse real estate finance, CCF loans and other financing products, fees for securities services, particularly for structuring and underwriting securitization transactions, and commissions on sales of asset management products.

Net fees and commissions for the fiscal year ended March 31, 2006 were ¥45.4 billion, an increase of ¥13.0 billion as compared to the previous fiscal year. The main

factor was an increase of ¥4.6 billion in fees from installment shopping credit, credit cards, guarantees and other financing to APLUS customers. Fees and commissions also increased from non-recourse real estate finance, securitization and other capital markets activities for institutional banking clients and from sales of asset management products such as mutual funds and variable annuities to retail customers.

Net Trading Income

The table below shows the principal components of net trading income.

Table 3. Net Trading Income

Fiscal years ended March 31	Billions of yen	
	2006	2005
Income from trading securities	¥ 7.7	¥ 1.8
Income from securities held to hedge trading transactions	2.2	2.1
Income from trading-related financial derivatives	17.6	19.8
Other, net	(0.1)	0.0
Net trading income	¥27.5	¥23.9

Net trading income reflects revenues from customer-driven transactions as well as transactions undertaken for our own trading purposes (that is, transactions seeking to capture gains arising from short-term changes in market value). In addition to investments in securities, it encompasses income we derive from providing derivative products, including structured deposits, to retail and institutional customers.

During the fiscal year ended March 31, 2006, we earned ¥27.5 billion in net trading income, as compared to ¥23.9

billion in the prior fiscal year. The increase in income from trading securities of ¥5.9 billion was attributable to trading Japanese government bonds and equity derivatives activities. This increase was partially offset by a decrease in income from trading-related financial derivatives, as option income generated in connection with interest-linked structured deposits provided to retail customers declined by approximately ¥5.2 billion, to ¥11.0 billion, due to changes in interest rates affecting the profitability of these products.

Net Other Business Income

The table below shows the principal components of net other business income.

Table 4. Net Other Business Income

Fiscal years ended March 31	Billions of yen	
	2006	2005
Income on monetary assets held in trust, net	¥ 23.5	¥16.8
Net gain on securities	6.1	4.7
Net gain on foreign exchanges	10.6	2.2
Net gain on other monetary claims purchased	17.1	14.9
Other business income (losses), net		
Income (losses) from derivatives for banking purposes, net	0.9	(0.5)
Equity in net income of affiliates	4.1	1.7
Gain on lease cancellation and other lease income, net	2.3	—
Other, net	7.1	4.3
Net other business income before income on leased assets and installment receivables, net	72.0	44.4
Income on leased assets and installment receivables, net	46.0	10.1
Net other business income	¥118.0	¥54.5

Net other business income mainly includes income on leased assets and installment receivables, net gain on securities and foreign exchanges, net gain on other monetary claims purchased for trading purposes and income on monetary assets held in trust. For purposes of our analysis of results of operations, we include income on leased assets and installment receivables in our discussion of net revenue on interest-earning assets because we consider such income to be similar in character to our interest income.

Net other business income for the fiscal year ended March 31, 2006 increased to ¥118.0 billion compared with ¥54.5 billion for the previous fiscal year. This increase was partly a result of income of ¥46.0 billion from the leased assets and installment receivables business of APLUS and Showa Leasing. Excluding such income, our net other business income for fiscal year 2005 was ¥72.0 billion, an increase of ¥27.6 billion compared with the previous fiscal year. The principal reason for the increase was the ¥8.3 billion increase in net gain on foreign exchanges, which was partly attributable to an increase in option income in connection with currency-linked structured deposits provided to retail customers of ¥7.5 billion, as well as fees on foreign exchange transactions.

Income on monetary assets held in trust increased ¥6.6 billion to ¥23.5 billion for the fiscal year ended March 31, 2006 consisting primarily of income from credit trading and gains on equity securities-related transactions. Income on monetary assets held in trust should be considered together with net gains on other monetary claims purchased for trading purposes as both of these income categories include credit trading and securitization income. In fiscal year 2005, we completed 43 new credit trading transactions with an aggregate investment amount of ¥76.3 billion. In addition, during the fiscal year, we concluded 14 new securitization deals with total issuance amount of ¥277.8 billion. As a result, net gain on other monetary claims purchased for trading purposes also increased ¥2.2 billion to ¥17.1 billion. Other business income from equity in net income of affiliates is primarily attributable to SHINKI Co., Ltd., Hillcot Holdings Limited, and BlueBay Asset Management Limited.

Total Revenue

Due to the factors described above, particularly the increases associated with our acquisitions of APLUS and Showa Leasing, total revenue in the fiscal year ended March 31, 2006 was ¥273.4 billion, an increase of ¥95.5 billion or 53.8% compared with the previous fiscal year.

General and Administrative Expenses

The table below sets forth the principal components of our general and administrative expenses:

Table 5. General and Administrative Expenses

Fiscal years ended March 31	Billions of yen	
	2006	2005
Personnel expenses	¥ 59.7	¥42.9
Premises expenses	20.4	14.6
Technology and data processing expenses	16.7	11.5
Advertising expenses	8.4	6.0
Consumption and property taxes	7.5	5.8
Deposit insurance premium	2.3	2.1
Other general administrative expenses	21.4	14.1
Total general and administrative expenses	¥136.5	¥97.3

Total general and administrative expenses for the fiscal year ended March 31, 2006 were ¥136.5 billion compared with ¥97.3 billion for the previous fiscal year. The increase was largely due to the inclusion of expenses of Showa Leasing, the full year impact of APLUS, increased customer and product support required as a result of growth in retail banking activity and the expansion of our retail banking distribution channels. This increase in expenses was partly offset by continued expense rationalization across all businesses.

Personnel expenses increased by ¥16.7 billion to ¥59.7 billion, of which ¥14.6 billion relate to the full year impact of APLUS and inclusion of Showa Leasing personnel expenses. Similarly, premises expenses increased by ¥5.7 billion mainly due to inclusion of Showa Leasing and the full year impact of APLUS.

Technology and data processing expenses increased by ¥5.2 billion to ¥16.7 billion in the fiscal year ended March 31, 2006. The increase was primarily due to the full year impact of APLUS's technology and data processing expenses of ¥3.5 billion as well as increased investments in new information technology systems and an increase in related maintenance and depreciation expenses.

Advertising expenses were ¥8.4 billion for fiscal year 2005, an increase of ¥2.3 billion compared to the previous fiscal year, reflecting the full year impact of APLUS's advertising expenses of ¥3.0 billion. This was partly offset by a decrease in retail banking advertising expenses of ¥0.8 billion as a result of decreased marketing activity.

Consumption and property taxes increased by ¥1.6 billion to ¥7.5 billion as compared to the previous fiscal year. This increase is largely attributable to inclusion of consumption and property taxes of Showa Leasing and the full year impact of APLUS as well as a general increase in consumption taxes from our increased business activities. Other general and administrative expenses, consisting of outsourcing and temporary staff expenses, professional fees, printing and stationery expenses, increased ¥7.2 billion compared to the previous fiscal year, due largely to an increase of ¥4.8 billion attributable to APLUS and Showa Leasing and an increase of ¥1.1 billion in retail banking pertaining to outsourcing, printing and stationery expenses to support business growth.

Net Credit Costs (Recoveries)

The following table sets forth our net credit costs and net credit recoveries on a consolidated basis for the fiscal years ended March 31, 2006 and 2005.

Table 6. Net Credit Costs (Recoveries)

Fiscal years ended March 31	Billions of yen	
	2006	2005
Losses on write-off of loans	¥ 1.1	¥ 3.5
Losses on sale of loans	0.3	—
Net provision (reversal) of reserve for loan losses:		
Net provision (reversal) of general reserve for loan losses	30.0	(2.7)
Net reversal of specific reserve for loan losses	(5.1)	(1.2)
Net reversal of reserve for loan losses to restructuring countries	(0.0)	(0.0)
Subtotal	24.8	(3.9)
Net provision (reversal) of specific reserve for other credit losses	1.1	(0.2)
Reversal of reserve for losses on sale of bonds	—	(0.2)
Other credit costs relating to leasing business	2.6	—
Net credit costs (recoveries)	¥30.1	¥(0.9)

The principal components of net credit costs (recoveries) are losses on loan write-offs and provisions or reversals of reserves.

In accordance with Japanese regulatory requirements, Shinsei maintains general and specific reserves for loan losses, a reserve for loans to restructuring countries, as well as a specific reserve for other credit losses. Certain of our subsidiaries, particularly APLUS and Showa Leasing, also maintain general and specific reserves for loan losses.

We recorded net credit costs of ¥30.1 billion for the fiscal year ended March 31, 2006 compared with net credit recoveries of ¥0.9 billion for the fiscal year ended March 31, 2005. The increase in net credit costs in fiscal year 2005 was largely due to the inclusion of Showa Leasing and full year impact of APLUS's net credit costs, including losses on write-off of loans. We incurred net credit costs of ¥30.4 billion and ¥3.1 billion in APLUS and Showa Leasing, respectively. This reflects credit costs associated with the ongoing operations of each of APLUS and Showa Leasing. These costs were partly offset by net credit recoveries of ¥4.9 billion at Shinsei as the credit quality of the loan portfolio in our banking businesses continued to improve.

Net credit recoveries in fiscal year 2004 were primarily attributable to an improvement in Shinsei's historical default ratio, which led to a decrease in the expected loss ratio used to calculate reserves for claims against normal and caution obligors. This was partly offset by APLUS's net credit costs of ¥12.7 billion in the second half of fiscal year 2004.

Amortization of Consolidation Goodwill and Other Intangibles

The acquisition of majority stakes in APLUS and Showa Leasing resulted in the creation of consolidation goodwill and other intangibles. The amortization of consolidation goodwill and other intangibles was ¥29.4 billion for the fiscal year ended March 31, 2006. This includes amortization of consolidation goodwill and other intangibles attributable to APLUS and Showa Leasing in the amount of ¥25.5 billion and ¥3.9 billion, respectively.

Other Losses, Net

Other losses, net were ¥ 3.4 billion for the fiscal year ended March 31, 2006, as compared to other losses, net of ¥7.0 billion during the previous fiscal year. Other losses, net in fiscal year 2005 included, among other things, ¥2.1 billion of one-time costs associated with our issuance of hybrid Tier I preferred securities.

Income before Income Taxes and Minority Interests

As a result of the foregoing, income before income taxes and minority interests totaled ¥73.7 billion for the fiscal year ended March 31, 2006, an ¥8.1 billion, or 12.4%, increase as compared to the previous fiscal year.

Income Taxes (Benefit)

For the fiscal year ended March 31, 2006, we recorded ¥3.7 billion in current income tax, ¥2.2 billion higher than for the previous year. This was mainly due to local income tax paid by our subsidiaries. We also recorded a deferred

income tax benefit of ¥11.4 billion, mainly to reflect the tax benefit on the amortization of fair value adjustments to net assets and other intangibles and the impact of deferred tax asset recognition calculated based on our projected taxable income for the following one-year period.

Minority Interests in Net Income of Subsidiaries

Minority interests in net income (loss) of subsidiaries of ¥5.2 billion for the fiscal year ended March 31, 2006 largely reflects minority interests relating to APLUS's preferred shareholders and Shinseigi Finance's subsidiaries.

Net Income

Our net income for the fiscal year ended March 31, 2006 amounted to ¥76.0 billion, an increase of ¥8.6 billion, or 12.8%, compared with the previous fiscal year. We report both Japanese GAAP net income and cash basis net income in order to provide greater transparency and understanding of our underlying performance. For the fiscal year ended March 31, 2006, consolidated cash basis net income was ¥101.9 billion, an increase of 36.4%

compared to the previous fiscal year. Cash basis net income is defined as Japanese GAAP net income adjusted to exclude the amortization of consolidation goodwill and other intangibles, net of tax benefit, attributable to APLUS and Showa Leasing.

Reconciliation from Reported-Basis Results to Operating-Basis Results

In addition to analyzing our results of operations in the format used for our financial statements, which we refer to as the "reported-basis," our management also reviews our results on an "operating-basis" to assess each of our business lines and to measure our results against targeted goals. Operating-basis results are calculated by adjusting the reported-basis results principally for the amortization of net actuarial losses, lump-sum payments, and certain revenue items. In essence, the operating-basis results represent what we consider to be "core" business results and are in conformity with Japanese GAAP at the net income level. The following summary table provides reconciliation between our results on a reported and operating basis.

Table 7. Reconciliation from Reported-Basis Results to Operating-Basis Results (Consolidated)

Fiscal years ended March 31	Billions of yen					
	2006			2005		
	Reported-basis	Reclassifications	Operating-basis	Reported-basis	Reclassifications	Operating-basis
Revenue:						
Net interest income	¥ 82.2	¥ —	¥ 82.2	¥ 66.8	¥ —	¥ 66.8
Non-interest income ⁽¹⁾	191.1	0.3	191.4	110.9	0.2	111.1
Total revenue	273.4	0.3	273.7	177.8	0.2	178.0
General and administrative expenses ⁽²⁾	136.5	(0.6)	135.9	97.3	(1.2)	96.0
Net business profit/Ordinary business profit ⁽³⁾	136.8	0.9	137.7	80.5	1.4	81.9
Net credit costs (recoveries)	30.1	—	30.1	(0.9)	—	(0.9)
Amortization of consolidation goodwill and other intangibles	29.4	—	29.4	8.8	—	8.8
Other losses, net ⁽¹⁾⁽²⁾	(3.4)	(0.9)	(4.4)	(7.0)	(1.4)	(8.5)
Income before income taxes and minority interests	73.7	—	73.7	65.5	—	65.5
Income tax benefit and minority interests	(2.3)	—	(2.3)	(1.8)	—	(1.8)
Net income	¥ 76.0	¥ —	¥ 76.0	¥ 67.4	¥ —	¥ 67.4

Notes:

(1) Reclassifications consist principally of adjustments relating to other business income between other (losses) gains, net and non-interest income.

(2) Reclassifications consist principally of adjustments relating to lump-sum compensation and amortization of net actuarial gains or losses from general and administrative expenses to other (losses) gains, net.

(3) Ordinary business profit is derived after reclassifying certain items from net business profit.

Business Lines Results

Our three strategic business lines, Institutional Banking, CCF and Retail Banking, cover a broad range of businesses and customer segments which provide us with diversified revenues. Management monitors the performance of these business lines on an operating basis. The business lines

discussion below covers the operating-basis ordinary business profit of the three business lines and a fourth category of ALM/Corporate/Other. During the fiscal year ended March 31, 2006, revenues of all three strategic business lines grew in line with our customer-focused, solution-driven business model.

Table 8. Operating-Basis Ordinary Business Profit by Business Line (Consolidated)

For the fiscal year ended March 31	Billions of yen				
	2006				
	Institutional Banking	Consumer and Commercial Finance	Retail Banking	ALM/Corporate/Other	Total
Net interest income	¥ 32.1	¥ 38.0	¥ 16.8	¥(4.7)	¥ 82.2
Non-interest income	84.4	81.7	25.5	(0.3)	191.4
Total revenue	116.6	119.7	42.4	(5.1)	273.7
General and administrative expenses	39.1	60.4	34.8	1.6	135.9
Ordinary business profit (loss)	¥ 77.5	¥ 59.3	¥ 7.6	¥(6.7)	¥ 137.7

For the fiscal year ended March 31	Billions of yen				
	2005				
	Institutional Banking	Consumer and Commercial Finance	Retail Banking	ALM/Corporate/Other	Total
Net interest income	¥ 35.3	¥ 17.2	¥ 15.2	¥(0.9)	¥ 66.8
Non-interest income	61.7	25.9	22.2	1.1	111.1
Total revenue	97.0	43.2	37.5	0.1	178.0
General and administrative expenses	37.8	26.1	31.6	0.4	96.0
Ordinary business profit (loss)	¥ 59.1	¥ 17.1	¥ 5.9	¥(0.2)	¥ 81.9

Institutional Banking

In fiscal year 2005, we continued to implement our “solution banking” approach in Institutional Banking, bringing investment banking services and expertise to our traditional customer base while also targeting new clients through close collaboration among our product specialists and relationship managers. This business is now positioned in Japan as a hybrid commercial and investment banking franchise. Our business model seeks to diversify sources of income. In particular, we have developed investment banking businesses that generate higher margin project-risk lending as well as fees, commissions, capital gains and other types of non-interest income to complement the interest income we earn from corporate-risk lending. These businesses include:

- specialty financing, such as acquisition and non-recourse financing;
- capital markets distribution activity, including wholesale distribution of deposits and note products through regional financial institutions;

- structured trading, including credit trading and securitization of numerous asset classes; and
- corporate advisory services relating to corporate revitalization and mergers and acquisitions.

Many of these businesses are relatively new to the Japanese banking industry and have been dominated by foreign investment banks, but we believe they have the potential to grow significantly. We also commit our own capital to proprietary investing and trading activities as market opportunities arise.

The Institutional Banking business generated total revenue of ¥116.6 billion in the fiscal year ended March 31, 2006, an increase of ¥19.5 billion, or 20.2%, from the previous fiscal year. Total Institutional Banking expenses increased marginally to ¥39.1 billion in the fiscal year ended March 31, 2006, or ¥1.2 billion higher than the previous fiscal year. The expense-to-revenue ratio of the Institutional Banking business improved to 33.5% in fiscal year 2005 compared with 39.0% for the previous fiscal year.

Table 9. Institutional Banking Revenue by Product

Fiscal years ended March 31	Billions of yen	
	2006	2005
Institutional Banking:		
Foreign exchange, derivatives, equity-related	¥ 31.4	¥16.7
Non-recourse real estate finance	20.2	18.9
Corporate loans	17.9	14.6
Credit trading	15.2	15.8
Securitization	14.7	12.6
Principal investments	6.0	7.8
Other capital markets	7.1	7.7
Other	3.8	2.6
Total revenue	¥116.6	¥97.0

The Institutional Banking business delivered strong results in foreign exchange, derivatives, equity-related, securitization, non-recourse real estate finance, corporate loans and credit trading activities. In fiscal year 2005, foreign exchange, derivatives and equity-related revenue grew ¥14.6 billion to ¥31.4 billion. Revenues came from diversified capital markets activities with our derivatives business being the most successful. Non-recourse real estate finance business concluded 135 new transactions. As a result, revenue from non-recourse real estate finance increased 7.0%, or ¥1.3 billion, to ¥20.2 billion for the fiscal year ended March 31, 2006.

Corporate loans increased by 16.3%, or ¥400.6 billion, to reach over ¥2.8 trillion at March 31, 2006, as compared with March 31, 2005. As a result, revenues from corporate loans increased to ¥17.9 billion for the fiscal year ended March 31, 2006, an increase of ¥3.3 billion, or 22.6%, compared to the previous fiscal year. In fiscal year 2005, we completed 43 new credit trading transactions with an aggregate investment amount of ¥76.3 billion and earned revenue of ¥15.2 billion. In the securitization business, we closed 14 new transactions in fiscal year 2005 with a total

issuance amount of approximately ¥277.8 billion, and revenue generated from securitization business increased 16.7% to ¥14.7 billion in the fiscal year ended March 31, 2006.

Consumer and Commercial Finance

To diversify our revenues further, we have established or acquired a number of CCF subsidiaries or affiliates that provide products such as mortgage loans, loans to SMEs and consumer loans.

The acquisition of APLUS and Showa Leasing during the fiscal year ended March 31, 2005 strengthened our CCF business into one that is now contributing significantly to our overall revenues while adding new customers, experienced personnel and technical capabilities and taking advantage of Shinsei's expertise and know-how. In the fiscal year ended March 31, 2006, our CCF business generated revenue of ¥119.7 billion, or 43.8% of our total revenue. Continued expense rationalization coupled with revenue growth improved the expense-to-revenue ratio of this business to 50.5% in the fiscal year ended March 31, 2006 compared to 60.4% for the previous fiscal year.

Table 10. Consumer and Commercial Finance Ordinary Business Profit by Subsidiary⁽¹⁾

Fiscal year ended March 31	Billions of yen			
	2006			
	APLUS	Showa Leasing	Other Subsidiaries ⁽²⁾	Consumer and Commercial Finance
Consumer and Commercial Finance:				
Total revenue	¥ 85.1	¥ 22.8	¥ 11.7	¥ 119.7
General and administrative expenses	43.0	10.5	6.8	60.4
Ordinary business profit	¥ 42.0	¥ 12.2	¥ 4.9	¥ 59.3

Fiscal year ended March 31	Billions of yen			
	2005			
	APLUS	Showa Leasing	Other Subsidiaries ⁽²⁾	Consumer and Commercial Finance
Consumer and Commercial Finance:				
Total revenue	¥ 36.2	¥—	¥ 7.0	¥ 43.2
General and administrative expenses	20.3	—	5.7	26.1
Ordinary business profit	¥ 15.8	¥—	¥ 1.2	¥ 17.1

Notes:

(1) Net of consolidation adjustments, if applicable.

(2) Includes profits of SHINKI, an affiliate, and unallocated CCF sub-group expenses.

For the fiscal year ended March 31, 2006, APLUS recorded total revenue of ¥85.1 billion on a consolidated basis from its installment shopping credit, credit cards businesses and loan guarantees. This represents 71% of total CCF business revenue. Showa Leasing is our commercial finance platform and provides general and auto leasing, lending and other financing solutions to small and medium-size companies and automobile dealerships. Showa Leasing and its certain subsidiaries recorded revenue of ¥22.8 billion, or over 19% of total CCF revenue, in fiscal year 2005.

Retail Banking

During fiscal year 2005, following the successful launch of Shinsei's brand strategy "Color your life", Shinsei Retail

added more than 437,000 new *PowerFlex* customers, compared to about 390,000 during the previous fiscal year. As of March 31, 2006, the Retail Banking business had more than 1.7 million retail accounts.

As of March 31, 2006, Shinsei had 30 Shinsei Financial Centers, and 6 "BankSpot" mini-branches. Our retail customers interact and transact with us not only through these physical outlets but also via our website, a network of over 60,000 ATMs located throughout Japan, and call centers open 24 hours a day, 7 days a week, including on Japanese national holidays. We have been installing ATMs in Tokyo Metro stations to provide further convenience to our customers. Our 55 ATMs at 30 stations represent the largest ATM network in the Tokyo Metro.

As evidence that our customer-focused Retail Banking strategy is working, our Retail Banking business was ranked first in the Nihon Keizai Shimbun's customer satisfaction survey of Japanese financial institutions for the past two years. We received particularly high ratings for our customer service, service at our branches, our hours of operation, and our products and services and we received favorable comments for future usage and the soundness and reliability of our services.

Total revenue of Retail Banking increased 13.0% to ¥42.4 billion in fiscal year 2005. The Retail Banking business had total expenses of ¥34.8 billion in the fiscal year ended March 31, 2006, an increase of ¥3.1 billion compared to the previous fiscal year due primarily to the expansion of distribution channels and increase in customer and product support as a result of growth in retail banking activities. Ordinary business profit was ¥7.6 billion for fiscal year 2005.

Table 11. Retail Banking Revenue by Product

Fiscal years ended March 31	Billions of yen	
	2006	2005
Retail Banking:		
Deposits and debentures non-interest income	¥18.3	¥16.5
Deposits and debentures net interest income	13.3	12.9
Asset management	7.4	6.0
Loans	3.2	1.9
Total revenue	¥42.4	¥37.5

Deposit and debentures non-interest income mainly includes income on structured deposits and commissions on foreign exchange transactions. This is partly offset by fees we incur in connection with ATMs and funds transfers. Deposits of retail customers increased by over 33.2% in the fiscal year ended March 31, 2006 due in part to the success of structured deposits, and the total of retail deposits was over ¥3.0 trillion as of March 31, 2006. In fiscal year 2005, we recorded revenue of ¥18.3 billion from deposits and debentures non-interest income, an increase of ¥1.8 billion compared to the previous fiscal year, mainly reflecting strong option income in connection with structured deposits.

Deposits and debentures net interest income relates to the internal interest spread we credit to our Retail Banking business on customer deposits and debentures. Deposits and debentures net interest income grew ¥0.3 billion to ¥13.3 billion in the fiscal year ended March 31, 2006 as a result of growth in retail deposits. Fees from asset management products increased 22.6% to ¥7.4 billion for the fiscal year ended March 31, 2006 compared to the previous fiscal year. Housing loans to retail customers grew 57.1%, or ¥165.3 billion, to ¥454.5 billion as of March 31, 2006. This resulted in Retail Banking recording ¥3.2 billion in revenue from housing loans and other lending products during fiscal year 2005.

ALM/Corporate/Other

ALM, Corporate and Other primarily includes results of corporate treasury activities, income from proprietary investments, inter-company eliminations, and corporate level activities. These activities resulted in ordinary business loss of ¥6.7 billion for the fiscal year ended March 31, 2006.

Summary of Non-Consolidated Financial Results**Overview**

We disclose non-consolidated financial information of Shinsei in addition to our consolidated financial statements. As a recipient of public funds, we are required by the FSA to update and report on Shinsei's achievement of non-consolidated performance targets set forth in its revitalization plan on a quarterly basis, and publicly disclose that information semiannually. Shinsei's plan was initially prepared by LTCB upon its emergence from nationalization and we have subsequently updated the plan in August 2001, August 2003 and August 2005.

Shinsei accounts for a substantial portion of our consolidated financial condition and results of operations. For the

fiscal year ended March 31, 2006, Shinsei accounted for 98.4% of our consolidated net income and 76.6% of our consolidated assets. While we believe that our subsidiaries will account for an increasingly greater portion of our consolidated assets and results of operations in the future, particularly as the result of the acquisitions of APLUS and Showa Leasing, our financial condition and results of operations currently continue to reflect predominantly those of Shinsei.

In the fiscal year ended March 31, 2006, growth in both the institutional banking and retail banking businesses led Shinsei to record higher non-consolidated gross business profit and net income than in the previous year. Shinsei's efforts to maintain fiscal discipline and net reversals on its reserve for credit losses, attributable to collections on and declines in its problem loan balance, among other reasons, led Shinsei to surpass in the fiscal year ended March 31, 2006 the net income target it set in its revitalization plan. The table below compares Shinsei's results for the fiscal year ended March 31, 2006 to targets in its revitalization plan:

Table 12. Comparison of Targets and Results for Key Measure in the Revitalization Plan (Non-Consolidated)

For the fiscal year ended March 31, 2006	Billions of yen (except percentages)	
	Target	Actual
Net income	¥68.0	¥74.8
Total expenses ⁽¹⁾	69.5	69.4
Return on equity based on net business profit ⁽²⁾	7.6%	8.4%

Note:

(1) Equals Shinsei's total general and administrative expenses excluding business taxes such as consumption tax.

(2) Equals net business profit before general reserve for loan losses, as such term is defined under "—Supplemental Non-Consolidated Measures" below, divided by average total shareholders' equity.

Supplemental Non-Consolidated Measures

In addition to the reporting items set forth in our non-consolidated financial statements, Japanese banking law requires us to disclose gross business profit (*gyomu sorieki*) on a non-consolidated basis. Furthermore, in the Japanese banking industry, net business profit before general reserve for loan losses (*jisshitsu gyomu jun-eki*) has traditionally been used as a measure of the profitability of core banking operations. We review these non-Japanese GAAP performance measures in monitoring the results of our operations. Gross business profit is the sum of:

- net interest income;

- net fees and commissions, which consist of:
 - fees on loans as well as on sales of asset management products,
 - other fee-based activities, and
 - income on monetary assets held in trust (in keeping with the definition of gross business profit in our revitalization plan);
- net trading income; and
- net other business income, which includes, among other things, gains or losses on securities and foreign exchanges.

Net business profit before general reserve for loan losses is gross business profit minus non-consolidated total expenses, which corresponds to our consolidated general and administrative expenses.

While these business profit measures should not be viewed as a substitute for net income, management believes that these non-Japanese GAAP measures provide a

meaningful way of comparing a number of the important components of Shinsei's revenues and profitability from year to year. The tables below set forth these supplemental financial data and corresponding reconciliations to net income under Japanese GAAP for the fiscal years ended March 31, 2006 and 2005.

Table 13. Supplemental Measures (Non-Consolidated)

Fiscal years ended March 31	Billions of yen	
	2006	2005
Gross business profit (<i>gyomu sorieki</i>) ⁽¹⁾ :		
Net interest income	¥ 53.1	¥ 54.8
Net fees and commissions ⁽¹⁾	50.9	41.0
Net trading income	20.2	22.1
Net other business income	18.0	5.7
Total gross business profit ⁽¹⁾	142.4	123.8
Total expenses	73.2	68.8
Net business profit ⁽¹⁾⁽²⁾ (<i>jisshitsu gyomu jun-eki</i>)	69.1	54.9
Other operating expenses, net ⁽³⁾	(8.6)	(8.2)
Net operating income (<i>keijo rieki</i>)	60.4	46.6
Extraordinary income	6.1	18.1
Income before income taxes	66.6	64.8
Current income taxes (benefit)	(5.9)	(2.3)
Deferred income tax (benefit) expense	(2.2)	(0.8)
Net income	¥ 74.8	¥ 68.0

Notes:

(1) Includes income from monetary assets held in trust of ¥39.5 billion in the fiscal year ended March 31, 2006, and ¥29.3 billion in the fiscal year ended March 31, 2005.

(2) Excludes provisions for or reversals of general reserve for loan losses.

(3) Excludes income from monetary assets held in trust.

Critical Accounting Policies

General

Our financial statements are prepared in accordance with Japanese GAAP. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenue and expenses during the reporting period. In addition, certain accounting principles require significant judgment by management in applying complex accounting principles to individual transactions to determine the most appropriate accounting treatment. We have established procedures and processes to facilitate making the estimates and assumptions necessary to value assets and liabilities, record transactions and prepare the financial statements. On an ongoing basis, management evaluates its estimates and judgments, including those related to the valuation of assets and liabilities. Although actual results may differ from these estimates under

different assumptions and conditions and future changes in the key assumptions could change future valuations and results, we have used the best information available at the time to make our estimates. Significant accounting policies are described in Note 2 to the Consolidated Financial Statements included in this annual report.

Management believes the following are our critical accounting policies. These policies were considered "critical" because:

- the estimates involved in these policies require us to make assumptions about matters that are uncertain at the time the estimates are made; and
- different estimates that we reasonably could have used in the current period, or changes in the accounting estimate that are reasonably likely to occur from period to period, could have a material impact on the presentation of our financial condition, or changes in our financial condition or results of operations.

Reserve for Credit Losses

The reserve for loan losses, a separate component of the reserve for credit losses, is management's estimate of the credit losses to be incurred in the lending portfolio and is discussed in further detail in "—Financial Condition—Asset Quality and Disposal of Problem Loans". We establish a specific reserve, a general reserve and a reserve for loans to restructuring countries based on our self-assessment manual to absorb estimated credit losses in the lending portfolio.

A specific reserve is provided for specific claims against obligors in the possibly bankrupt, virtually bankrupt and legally bankrupt categories. For claims against obligors in the virtually and legally bankrupt categories, the unsecured, unguaranteed portion of the claim is written off or otherwise fully reserved because such portion is deemed unlikely to be collected. For claims against obligors in the possibly bankrupt category, a specific reserve is principally determined by estimating discounted future cash flows, other than in cases where it is difficult to reasonably estimate future cash flow.

A general reserve is provided for claims against normal obligors, as well as claims against caution obligors (including substandard obligors). Shinsei applies the discounted cash flow method in calculating the amount of a general reserve for most of its claims against substandard obligors. The amount of the reserve for claims against normal obligors and claims against caution obligors (other than substandard obligors of Shinsei which are subject to the discounted cash flow method) is based on the total amount of, as well as the expected loss ratios for, claims against each category of obligor. Shinsei calculates expected loss ratios based on historical losses on claims against each obligor category. Using the expected loss ratios, Shinsei reserves for the estimated amount of losses for the next three years for claims against substandard obligors, for the remaining term of the claims with respect to claims against normal obligors given ratings of 5A through 6C in Shinsei's credit ratings system (described under "—Risk Policy and Management—Credit Risk Management"), and claims against caution obligors other than substandard obligors, or other caution obligors, and for the next year for claims against normal obligors given ratings higher than 5A.

Shinsei reviews its classification of obligors quarterly, although every month it downgrade obligors whose financial condition has deteriorated based on the results of its self-assessment process. A reserve for loans to restructuring countries is provided for estimated losses on those loans due to political and economic conditions in the countries where the loans are outstanding, based on losses estimated using the secondary market price of similar loans.

Estimating Shinsei's specific reserve for claims against obligors in the possibly bankrupt category and the general reserve for claims against obligors in the substandard category is subject to a number of significant judgments and uncertainties regarding discounted cash flows due to the changing financial conditions of the obligors and general economic conditions surrounding the obligors' business operations. In addition, because the secured portion of claims is not covered by a specific reserve, actual losses on such claims are also subject to significant judgments and uncertainties regarding the fair value of collateral. Estimating the general reserve for claims against obligors in the normal and other caution categories could be affected by changes made by management in the methodologies used to calculate the migration analyses of obligors or the assumptions used in the calculation of the reserve. As a result, actual losses in the lending portfolio could be greater or smaller than we have estimated. If the estimated credit losses were not enough to cover actual losses incurred from the ultimate disposition of the portfolio, it would result in additional write-offs or additional reserves in the future for the lending portfolio, increasing our reported total credit costs. If the estimate were in excess of actual losses, it would result in a reduction of our total credit costs.

The reserve for other credit losses consists primarily of reserves, including a reserve taken on our contribution to an industry-wide fund set up to purchase and collect loans, and a reserve for losses in connection with our potential claims against the DIC, including in connection with our ongoing litigation. A specific reserve has been established for each of these exposures based on our estimate of the prospects for recovery. Although we believe our existing reserves are sufficient to cover the risk from items we have identified, actual losses related to these items could be more or less than we have estimated, which could result in an increase or a decrease in our total credit costs.

APLUS establishes loan loss reserves based on historical loss rates for delinquent and non-delinquent accounts. The amount of reserves in the case of delinquent accounts primarily depends on the number of months for which a particular account is past due. In addition, APLUS writes off the entire amount of any claims it deems uncollectible, either as a result of personal bankruptcy or otherwise. Showa Leasing establishes loan loss reserves in the same manner as APLUS except that with respect to customers with exposure above a specified amount, Showa Leasing establishes reserves on the basis of obligor classification in accordance with its self-assessment guidelines.

Valuation of Financial Instruments Measured at Fair Value

We have various types of financial instruments on our trading and banking books. Pursuant to Japanese GAAP, we record some of our financial instruments at their fair values, which are measured based on market prices or third-party quotes or, if both are unavailable, our internal valuation methodologies.

Although we strive to follow market standards in making assumptions and determining scenarios necessary for these valuation methodologies, the outcomes of our methodologies could differ from those derived from other methodologies.

Available-for-Sale Securities

We generally record available-for-sale securities, both debt and equity, at their fair values. The net unrealized gains or losses on these securities are included in and presented as a component of shareholders' equity.

Available-for-sale securities include some securities without readily obtainable market prices or quotes. These securities mainly consist of residual interests and debt investments in collateralized debt obligations as well as illiquid corporate bonds. We estimate the fair values of these securities based on historical data concerning market prices and quotes. In some cases, we determine fair value using internal valuation methodologies that are subject to complex assumptions, including those relating to scenarios, interest rates and volatility.

As of March 31, 2006 and 2005, the amortized cost of our available-for-sale securities without readily determinable fair value was ¥280.9 billion and ¥223.5 billion, respectively. The total fair value of our available-for-sale securities as of March 31, 2006 and 2005 was ¥854.9 billion and ¥1,182.5 billion, respectively, while net unrealized gains were ¥3.5 billion and ¥5.2 billion, respectively.

Impairment in Value of Debt and Equity Securities

Available-for-sale debt and equity securities and held-to-maturity debt securities are both exposed to the risk of decline in their fair values. If the fair value of a security at a measurement date has declined in excess of 50% of its cost, unless there is strong evidence that the fair value will recover quickly and substantially from the decline, we recognize an impairment in book value of the security since the decline in fair value is deemed to be other than temporary. If the fair value of a security has declined by an amount ranging from 30% to 50% of its cost, we consider the possibility of recovery of fair value in order to determine whether an other-than-temporary impairment has occurred. Our judgment of the possibility and magnitude of a future

recovery in fair value relies on our subjective views concerning market uncertainties, the creditworthiness of the issuers of the securities and various other factors. Different judgments could lead to different conclusions regarding the need to recognize impairments in value.

For the fiscal year ended March 31, 2006, we recognized losses of ¥0.3 billion on debt and equity securities available-for-sale due to impairment, as compared to ¥1.4 billion for the fiscal year ended March 31, 2005, mainly due to impairment of foreign securities.

Financial Assets and Liabilities Held for Trading Purposes

Our trading book assets and liabilities consist of derivative financial instruments, securities, short-term money market investments and other monetary claims maturing within a short period of time.

In addition, we hold certain securities investments, such as foreign fund trusts and corporate bonds, financial assets backed by loans and receivables as well as mortgages included in securities, other monetary claims purchased and monetary assets held in trust that are not recorded in the trading book, but are held for trading purposes in the banking book. All of these trading-purpose assets and liabilities are booked at their fair values, and changes in value are reflected in our net income. The fair values of trading-purpose assets that are traded actively in open markets are based on observable market prices of the same or similar securities and monetary claims.

When actively traded market prices are not available, we estimate the fair values of the assets and liabilities held for trading purposes using our internal valuation methodologies. These methodologies require us to use our judgment in both making assumptions regarding market parameters, such as swap rates for interest rate and currency swaps with longer maturities, as well as determining the required scenarios, such as future cash flow projections for financial assets underlying purchased monetary claims. In addition, we adjust the fair value estimates for derivative financial instruments to account for credit and liquidity risks.

As of March 31, 2006, the net fair value of our trading assets and liabilities was ¥43.5 billion and the net balance of revaluation gains on those assets and liabilities was ¥49.2 billion. This compared with a net fair value of ¥99.4 billion and a net balance of revaluation gains of ¥27.6 billion as of March 31, 2005.

The fair value of securities held in our banking book for trading purposes was ¥162.6 billion and ¥48.5 billion as of March 31, 2006 and 2005, respectively. The fair value of other monetary claims purchased was ¥177.3 billion and ¥189.9 billion as of March 31, 2006 and 2005, respec-

tively. The fair value of monetary assets held in trust was ¥277.4 billion and ¥218.2 billion as of March 31, 2006 and 2005, respectively.

Credit Trading Activities

We are engaged in credit-trading activities in Japan and foreign countries, in which we purchase monetary claims such as loans, bonds, guarantees, receivables and lease receivables without intending to hold them to maturity. To recover our investment, we either collect on the claim, including through repayments, legal proceedings and discounted payoffs, or resell or securitize the claim. Claims purchased are recorded either in monetary assets held in trust or other monetary claims purchased, depending on the structure used for the purchase, and are principally measured at fair value. Fair value is estimated in the same way as it is for assets held for trading purposes. The internal valuation methodology we use to calculate the fair value of these claims mainly relies on a discounted cash flow approach based on cash flow projections and implied market discount rates. As estimations of future cash flows and discount rates are based on complex processes and contain an element of judgment, changes in assumptions could lead to different estimates of the fair value of monetary assets held in trust and other monetary claims purchased, which could in turn impact the related gain or loss amounts in our financial statements. As of March 31, 2006 and 2005, balances related to credit trading of ¥246.8 billion and ¥197.0 billion, respectively, were included in monetary assets held in trust and ¥157.5 billion and ¥120.3 billion, respectively, were included in other monetary claims purchased for trading purposes. As of March 31, 2006 and 2005, net unrealized losses recorded in those accounts were ¥11.1 billion and ¥3.8 billion, respectively.

Valuation of Deferred Tax Assets

We record deferred tax assets for deductible temporary differences and tax loss carryforwards and evaluate them in accordance with the guidelines of the Japanese Institute of Certified Public Accountants, or JICPA. Under the JICPA guidelines for the valuation of deferred tax assets, if a company records a material amount of tax loss carryforwards, in most cases, it is deemed difficult to reasonably estimate "Taxable Income" (which, for the purpose of utilizing deferred tax assets, is treated as income before adjustments for existing temporary differences and tax loss carryforwards). If, however, a company is able to reasonably estimate future Taxable Income for the next year, it may record deferred tax assets based on deductible temporary differences and tax loss carryforwards to the extent that it is

probable that those differences or carryforwards would be used during the next year. In addition, the JICPA guidelines provide that a company with a material amount of tax loss carryforwards could recognize deferred tax assets as realizable based on future Taxable Income, reasonably estimated, for up to the next five years if the tax loss carryforwards had been incurred due to certain non-recurring events, such as the restructuring of businesses, and there was not necessarily any significant doubt as to the company's ability to earn Taxable Income in the future.

As a result of Taxable Income (as defined in the previous paragraph) recorded in recent periods, we could have recorded deferred tax assets realizable based on a reasonable estimate of income for at least a part of the next five years if we could have demonstrated that we would record actual income for the foreseeable future. We have evaluated the available evidence concerning our future Taxable Income and other possible sources of realization of deferred tax assets, and have concluded that it would be appropriate to record deferred tax assets that are realizable only in the following year for Shinsei and most of its subsidiaries. We have recorded a valuation allowance to reduce deferred tax assets accordingly. The actual Taxable Income amount for the fiscal year ending March 31, 2007 may be different from our estimate, which would result in a larger or smaller amount of deferred tax assets that should have been recognized.

As of March 31, 2006 and 2005, our balance of net deferred tax assets, or the difference between our deferred tax assets and our deferred tax liabilities, was ¥16.3 billion and ¥4.3 billion respectively. The amount of net deferred tax assets was 2.2% of our Tier I capital as of March 31, 2006 and 0.9% of our Tier I capital as of March 31, 2005. If we had concluded that we could reasonably estimate Taxable Income for the next five years, as of March 31, 2006, the balance of net deferred tax assets could have been significantly higher.

Reserve for Retirement Benefits

Shinsei, APLUS and Showa Leasing each have a non-contributory defined benefit pension plan and certain of Shinsei's consolidated Japanese subsidiaries have unfunded severance indemnity plans, which cover substantially all of our employees. A reserve for retirement benefits is provided for payment in future years. We follow guidelines for accounting for employee retirement benefit plans issued by the JICPA and estimate the amounts of the retirement benefit obligations and plan assets under the pension plans at the end of the fiscal year using assumptions for the expected rate of return on plan assets and the discount rate.

Expected Rate of Return on Plan Assets

We determine the expected rate of return on plan assets based on the targeted average long-term performance of the assets. Because assumptions regarding the rate of return on assets are affected by changing general economic and market conditions, we need to make significant judgments to determine appropriate assumptions underlying the estimate of long-term performance, which also impact the estimate of the reserve for retirement benefits and net periodic pension cost. For the fiscal years ended March 31, 2006 and 2005, the expected rate of return was between 1.5% and 3.5% and between 2.2% and 3.5%, respectively.

Discount Rate

We have selected the interest rate for Japanese government bonds with a 20-year maturity as the basis for the discount rate. We have determined that the interest rate for Japanese government bonds with a 20-year maturity is the best estimate of the risk-free rate because we estimated that the period of time for effective settlement of the benefit obligation under the pension plans would be approximately 18 years on average and the risk-free rate for a period of 18 years was assumed to be substantially the same as the interest rate for a 20-year maturity Japanese government bond. This assumption could change if we become aware of information that leads us to determine that a different period for settling the benefit obligation is required. A change in that assumption could, in turn, change the discount rate and the amounts reported in our financial statements. Changing our methodologies for calculating the estimated settlement period would also affect our estimate of the discount rate and amounts in our financial statements. For the fiscal year ended March 31, 2006 and 2005, the discount rate was between 1.5% and 2.2% and between 2.0% and 2.2%, respectively. Had the discount rate decreased 0.5 percentage points, net periodic pension cost for the fiscal year ended March 31, 2006 would not have increased materially.

Hedge Accounting

We follow guidelines issued by the JICPA regarding hedge accounting applicable to assets and liabilities exposed to a risk of change in fair value or cash flow. Derivative transactions that meet the hedge accounting criteria are primarily accounted for under a deferral method whereby unrealized gains and losses are deferred as assets or liabilities until the gains and losses on the hedged items are realized.

Until the end of the fiscal year ended March 31, 2003, Shinsei principally applied a "macro hedge" approach for interest rate derivatives used to manage interest rate risks and its ALM activities based on the transitional treatment

prescribed in Industry Audit Committee Report No. 24 issued by the JICPA ("Report No. 24"). The effectiveness of the macro hedge approach was reviewed for a reduction in interest rate risk exposure and the actual risk amount of derivatives within the preapproved limit under our risk control policies. Effective April 1, 2003, we adopted portfolio hedging in accordance with Report No. 24. Under portfolio hedging, a portfolio of hedged items such as deposits or loans with common maturities is matched with a group of hedging instruments such as interest rate swaps, which offset the effect of fair value fluctuations of the hedged items by identified maturities, and are designated as a hedge of the portfolio. The effectiveness of the portfolio hedge is assessed by each group. The interest rate swaps of certain consolidated subsidiaries which qualify for hedge accounting and meet specific matching criteria are not remeasured at fair value but the net payments or receipts under the swap agreements are recognized and included in interest expenses or income. Also, our consolidated Japanese leasing subsidiaries partly apply deferral hedge accounting in accordance with Industry Audit Committee Report No. 19 of the JICPA.

Shinsei accounts for fund swap and certain currency swap transactions using either deferral hedge accounting or fair value hedge accounting in accordance with Industry Audit Committee Report No. 25 of the JICPA. Fund swap transactions are foreign exchange swaps, and consist of spot foreign exchange contracts bought or sold and forward foreign exchange contracts sold or bought. Such transactions are contracted for the purpose of lending or borrowing in a different currency and converting 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 contracts bought or sold. Under deferral hedge accounting, hedged items are identified by grouping the foreign currency-denominated financial assets and liabilities by currencies and designating derivative transactions such as currency swap transactions and forward exchange contracts as hedging instruments. Hedge effectiveness is reviewed by comparing the total foreign currency position of the hedged items and hedging instruments by currency.

Shinsei also applies deferral hedge accounting and fair value hedge accounting to translation gains or losses from foreign currency assets of net investments in foreign affiliates and securities available-for-sale (other than bonds denominated in foreign currencies) when such foreign currency exposures recorded as assets are hedged with offsetting foreign currency liabilities and the liabilities exceed the acquisition cost of such foreign currency assets.

For the fiscal year ended March 31, 2006, net unrealized losses on hedging instruments which were deferred and recorded as assets amounted to ¥11.5 billion. For the fiscal year ended March 31, 2005, net unrealized gains on hedging instruments which were deferred and recorded as liabilities amounted to ¥1.2 billion.

Impairment of Long-Lived Assets

We review our long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of assets may not be recoverable. Impairment losses on an individual asset or a group of assets establish a new cost basis for the assets. We evaluate our long-lived assets for impairment, using our best estimates based on reasonable and supportable assumptions and projections. We recorded no impairment losses on long-lived assets for the fiscal years ended March 31, 2006 and 2005.

Business Combinations

For consolidated financial statement purposes, assets and liabilities of acquired subsidiaries are recorded primarily on the basis of their estimated fair values at the date of the acquisition.

We acquired a controlling interest in APLUS and Showa Leasing on September 29, 2004 and March 23, 2005, respectively. In connection with the consolidation of APLUS and Showa Leasing, we recognized the assets (including intangibles) and liabilities of APLUS and Showa Leasing primarily at their fair values. We used quoted market prices in active markets as the best evidence of fair value, where available. If quoted market prices were not available, the estimate of fair value was based on the best information available, including prices for similar assets and liabilities and the results of using other fair value measurement techniques. We adopted the following methodologies based on the nature of the assets and liabilities being valued and the availability of information:

- market approach: market transactions involving the sale of comparable assets;
- income approach: present value of earnings attributable to the asset; and
- cost approach: reproduction or replacement costs adjusted for depreciation and obsolescence.

As a result of fair value recognition, reserves for credit losses were offset with the corresponding loans or other assets.

We also recognized certain identifiable intangible assets in connection with the acquisition of APLUS and Showa Leasing because they arose from contractual or other legal rights, or were separable. The identified intangible assets

consist of APLUS and Showa Leasing's trade names, customer and/or merchant relationships, among others, which are valued using variations of the income approach and which are being amortized over various periods and using different methodologies depending on the nature of the asset. See Note 2(b) to the Consolidated Financial Statements.

The excess of the purchase price over the fair value of the net assets acquired, including identified intangible assets, was recorded as consolidation goodwill and is being amortized on a straight-line basis over 20 years. The amortization period is the maximum period as defined in accounting principles generally accepted in Japan. However, both APLUS and Showa Leasing had significant tax loss carryforwards and deductible temporary differences for which no deferred tax assets were recognized at the time of the acquisition due to uncertainty concerning their ultimate realization. Had we recognized the related deferred tax assets at the time of the acquisition, consolidation goodwill would have been reduced. Under Japanese GAAP, any future recognition of the benefits of the tax loss carryforwards or temporary differences (the carryforward period for tax loss carryforwards being generally limited to seven years) that existed at the acquisition would result in accelerated goodwill amortization. Any unamortized balances of identified intangible assets and consolidation goodwill are subject to impairment testing.

See "Recently Issued Accounting Pronouncements" below for discussion of the forthcoming treatment of accounting for business combinations.

Recently Issued Accounting Pronouncements

Business Combination and Business Separation

In October 2003, the Business Accounting Council (BAC) issued a Statement of Opinion, *Accounting Standard for Business Combinations*, and on December 27, 2005 the Accounting Standards Board of Japan (ASBJ) issued *Accounting Standard for Business Separations* and ASBJ Guidance No.10, *Guidance for Accounting Standard for Business Combinations and Business Separations*. These new accounting pronouncements are effective for fiscal years beginning on or after April 1, 2006.

The accounting standard for business combinations allows companies to apply the pooling of interests method of accounting only when certain specific criteria are met such that the business combination is essentially regarded as a uniting-of-interests. These specific criteria are as follows:

- (a) the consideration for the business combination consists solely of common shares with voting rights,

- (b) the ratio of voting rights of each predecessor shareholder group after the business combination is nearly equal, and
- (c) there are no other factors that would indicate any control exerted by any shareholder group other than voting rights.

For business combinations that do not meet the uniting-of-interests criteria, the business combination is considered to be an acquisition and the purchase method of accounting is required. This standard also prescribes the accounting for combinations of entities under common control and for joint ventures. Goodwill, including negative goodwill, is to be systematically amortized over 20 years or less, but is also subject to an impairment test.

Under the accounting standard for business separations, in a business separation where the interests of the investor no longer continue and the investment is settled, the difference between the fair value of the consideration received for the transferred business and the book value of net assets transferred to the separated business is recognized as a gain or loss on business separation in the statement of income. In a business separation where the interests of the investor continue and the investment is not settled, no such gain or loss on business separation is recognized.

Stock Options

On December 27, 2005, the ASBJ issued *Accounting Standard for Stock Options and related guidance*. The new standard and guidance are applicable to stock options newly granted on and after May 1, 2006.

This standard requires companies to recognize compensation expense for employee stock options based on the fair value at the date of grant and over the vesting period as consideration for receiving goods or services. The standard also requires companies to account for stock options granted to non-employees based on the fair value of either the stock option or the goods or services received. In the

balance sheet, the stock option is presented as a stock acquisition right as a separate component of shareholders' equity until exercised. The standard covers equity-settled, share-based payment transactions, but does not cover cash-settled, share-based payment transactions. In addition, the standard allows unlisted companies to measure options at their intrinsic value if they cannot reliably estimate fair value.

Presentation of Shareholders' Equity

In December 2005, the ASBJ published a new accounting standard for presentation of shareholders' equity. Under this accounting standard, certain items which were previously presented as liabilities are now presented as components of shareholders' equity. Such items include stock acquisition rights, minority interest, and any deferred gain or loss on derivatives accounted for under hedge accounting. This standard is effective for fiscal years ending on or after May 1, 2006.

Financial Condition

Total Assets

As of March 31, 2006, we had consolidated total assets of ¥9,405.0 billion. This represented a 9.6% increase from ¥8,576.3 billion as of March 31, 2005. The increase was principally attributable to an increase in loans and bills discounted and cash and due from banks, partly offset by a decrease in customers' liabilities for acceptances and guarantees in APLUS.

Securities

The following table sets forth the composition of our consolidated portfolio of available-for-sale equity and debt securities and held-to-maturity debt securities as of March 31, 2006. As reflected below, most of the securities will mature during the next five years.

Table 14. Securities by Maturity (Consolidated)

	Billions of yen							Total
	As of March 31, 2006							
	One year or less	Over one year to three years	Over three years to five years	Over five years to seven years	Over seven years to ten years	Over ten years	Unspecified term	
Japanese national government bonds	¥146.6	¥192.8	¥ 90.0	¥ —	¥ 2.4	¥ 46.5	¥ —	¥ 478.5
Japanese local government bonds	81.1	0.0	—	0.0	—	—	—	81.1
Japanese corporate bonds	319.9	141.4	26.0	2.6	0.7	25.9	—	516.7
Japanese equity securities	—	—	—	—	—	—	50.4	50.4
Foreign bonds and other	7.1	56.0	50.9	24.3	34.7	66.4	127.8	367.5
Total securities	¥554.8	¥390.4	¥166.9	¥27.0	¥37.8	¥138.9	¥178.3	¥1,494.4

Loan Portfolio

As of March 31, 2006, we had ¥4,087.5 billion in loans and bills discounted. This represented 43.5% of total consolidated assets and a 19.2% increase from the ¥3,430.4 billion of loans and bills discounted as of March 31, 2005. Installment receivables of APLUS, Showa Leasing and our other non-bank subsidiaries are classified in our consolidated balance sheet as other assets, and are not reflected in our data on loans and bills discounted.

Most of our loan portfolio was originated by Shinsei and our domestic subsidiaries. Of loans we originated, loans to

the finance and insurance industry and the real estate industry constituted close to one half as of March 31, 2006. Of the ¥949.6 billion in loans to the finance and insurance industry, ¥146.9 billion consisted of loans to public sector financial institutions or government-related institutions. In addition, about one-half of loans to the real estate industry as of March 31, 2006 consisted of non-recourse, project finance loans. Loans to this industry increased by 20.8%, to ¥1,030.0 billion, or 25.7% of total domestic loans, primarily because of an increase in loans to government-related institutions.

Table 15. Loans by Borrower Industry (Consolidated)

As of March 31	Billions of yen (except percentages)			
	2006		2005	
Domestic offices (excluding Japan offshore market accounts):				
Manufacturing	¥ 165.6	4.1%	¥ 193.9	5.7%
Mining	6.4	0.2	1.9	0.1
Construction	21.9	0.5	23.9	0.7
Electric power, gas, heat supply and water supply	99.7	2.5	120.5	3.6
Information and communications	31.6	0.8	21.3	0.6
Transportation	409.2	10.2	427.4	12.6
Wholesale and retail	90.2	2.3	59.7	1.8
Finance and insurance	949.6	23.7	770.3	22.7
Real estate	1,030.0	25.7	852.5	25.1
Services	173.8	4.3	149.4	4.4
Local government	75.2	1.9	139.8	4.1
Others	949.8	23.7	632.3	18.6
Total domestic (A)	¥4,003.6	100.0%	¥3,393.4	100.0%
Overseas offices (including Japan offshore market accounts):				
Governments	¥ 0.4	0.6%	¥ 0.1	0.5%
Financial institutions	—	—	—	—
Others	83.3	99.4	36.7	99.5
Total overseas (B)	¥ 83.8	100.0%	¥ 36.9	100.0%
Total (A) + (B)	¥4,087.5		¥3,430.4	

Loan Maturity

The following table sets forth the composition of Shinsei's non-consolidated loan portfolio by type of interest rate and maturity as of the dates indicated. In the fiscal year ended March 31, 2006 an increase in variable-interest rate loans was more than offset by a decrease in fixed-interest rate loans.

Table 16. Loan Maturity (Non-Consolidated)

As of March 31	Billions of yen	
	2006	2005
Fixed-interest loans:		
One year or less ⁽¹⁾	¥ —	¥ —
Over one year to three years	117.0	209.9
Over three years to five years	131.8	124.9
Over five years to seven years	144.0	207.2
Over seven years	626.0	545.6
Indefinite term	4.2	32.4
Variable-interest loans:		
One year or less ⁽¹⁾	¥ —	¥ —
Over one year to three years	768.0	562.2
Over three years to five years	615.4	335.9
Over five years to seven years	142.7	125.5
Over seven years	143.3	70.3
Indefinite term	14.2	35.3
Total loans:		
One year or less	¥1,254.2	¥1,193.9
Over one year to three years	885.1	772.1
Over three years to five years	747.3	460.9
Over five years to seven years	286.7	332.8
Over seven years	769.3	616.0
Indefinite term	18.5	67.7
Total loans	¥3,961.2	¥3,443.7

Note:

(1) Loans with maturities of one year or less are not broken down by type of interest rate.

Asset Quality and Disposal of Problem Loans of Shinsei

At March 31, 2006, 50.0% of our consolidated problem loans as disclosed in accordance with the guidelines of the Japanese Bankers' Association were held by Shinsei and the rest were held mainly by APLUS. This discussion of our asset quality presents information of Shinsei on a non-consolidated basis unless specified otherwise. In particular, problem claims as defined in the Financial Revitalization Law are only disclosed on a non-consolidated basis, and therefore do not include problem loans held by APLUS. For a discussion of the problem claims of APLUS and Showa Leasing see "Asset Quality of APLUS and Showa Leasing."

We classify our obligors and assess our asset quality based on our self-assessment manual developed in accordance with guidelines published by the FSA. We generally perform our self-assessment quarterly and at least

semiannually. The self-assessment process involves classifying obligors based on their financial condition and then categorizing claims against obligors in order of collection risk. For a discussion of our process of categorizing obligors, see "Risk Policy and Management—Credit Risk Management." Based on these classifications we establish reserves and disclose our problem loans and other claims using criteria specified in the Financial Revitalization Law. We also disclose our problem loans under a format devised by the Japanese Bankers Association for the disclosure of risk-monitored loans.

The following table compares the scope of each category of claim under the Financial Revitalization Law and each type of risk-monitored loan, as well as the obligor type to which they relate:

Comparison of Categories of Obligors, Claims under the Financial Revitalization Law and Risk-Monitored Loans

Obligor type	Claims under the Financial Revitalization Law ⁽¹⁾⁽²⁾	Risk-monitored loans ⁽¹⁾
Legally bankrupt	Claims against bankrupt and quasi-bankrupt obligors	Loans to bankrupt obligors
Virtually bankrupt		Non-accrual delinquent loans
Possibly bankrupt	Doubtful claims	
(Substandard)	Substandard claims	Restructured loans
	(Other claims against substandard obligors)	
Caution		
Normal	Normal claims	

Notes:

- (1) The Financial Revitalization Law requires us to classify and disclose “claims,” which include, in addition to loans and bills discounted, foreign exchange claims, securities lent, accrued income and suspense payment in other assets, as well as customers’ liabilities for acceptances and guarantees. By comparison, the format devised by the Japanese Bankers Association only classifies, and calls for disclosure of, certain loans.
- (2) Shaded claims denote claims that are considered to be non-performing under the Financial Revitalization Law.

In October 2002, the FSA announced a new “Program for Financial Revival” that has led to more stringent evaluations of claims. This program required banks to use discounted cash flow analyses, among other measures, when providing loan loss reserves against major borrowers with substandard claims. Through the program, the FSA also sought greater scrutiny of the effect of banks’ recording

large amounts of deferred tax assets on the quality of their regulatory capital. We have gone well beyond the FSA’s requirements for employing the discounted cash flow method, applying it to approximately 90%, by principal amount, of our claims against substandard obligors and possibly bankrupt obligors.

Self-Assessment Guidelines and Reserve Policies

Definition of Obligor Classifications	
Obligor classification	Definition
Legally bankrupt (<i>hatan-saki</i>)	Obligors who have already gone bankrupt, from both a legal and/or formal perspective.
Virtually bankrupt (<i>jisshitsu hatan-saki</i>)	Obligors who have not yet gone legally or formally bankrupt but who are substantially bankrupt because they are in serious financial difficulties and are not deemed to be capable of restructuring.
Possibly bankrupt (<i>hatan kenen-saki</i>)	Obligors who are not yet bankrupt but are in financial difficulties and are very likely to go bankrupt in the future because they are having difficulty implementing their management improvement plans. This includes obligors who are receiving ongoing support from financial institutions.
Caution (<i>youchui-saki</i>)	Obligors who require close attention because there are problems with their borrowings, such as reduced or suspended interest payments, problems with fulfillment, such as substantial postponements of principal or interest payments, or problems with their financial positions as a result of their poor or unstable business conditions. The term "caution obligors" includes "substandard obligors" (<i>youkanri-saki</i>), which refers to obligors with "substandard claims," that is, loans past due for more than three months or restructured loans. Claims against caution obligors that are not substandard claims are sometimes referred to as "other claims against caution obligors" (<i>sonota youchui-saki</i>).
Normal (<i>seijo-saki</i>)	Obligors whose business conditions are favorable and who are deemed not to have any particular problems in terms of their financial position.

Definitions of Claims Classified Under the Financial Revitalization Law	
Category	Definition
Claims against bankrupt and quasi-bankrupt obligors (<i>hasan kosei saiken oyobi korera ni junzuru saiken</i>)	Claims against obligors under bankruptcy and similar claims, as provided for under the Bankruptcy Law, the Corporate Reorganization Law, the Civil Rehabilitation Law and similar laws.
Doubtful claims (<i>kiken saiken</i>)	Claims against obligors that are not yet in bankruptcy but have experienced deterioration in their financial condition and operating performance and for which there is a high probability of contractual defaults on principal and interest payments.
Substandard claims (<i>youkanri saiken</i>)	Loans past due for three months or more and restructured loans, excluding those categorized as claims against bankrupt and quasi-bankrupt obligors or doubtful claims.
Normal claims (<i>seijo saiken</i>)	Claims against obligors that are experiencing no particular problems with their financial condition or operating performance, other than claims in any of the three categories above.

Definitions of Categories of Risk-Monitored Loans

Category	Definition
Loans to bankrupt obligors (<i>hatan-saki saiken</i>)	Loans to legally bankrupt obligors.
Non-accrual delinquent loans (<i>entai saiken</i>)	Loans to virtually bankrupt and possibly bankrupt obligors.
Loans past due for three months or more (<i>san-ka-getsu ijou entai saiken</i>)	Loans on which principal and/or interest are past due three months or more.
Restructured loans (<i>kashidashi jouken kanwa saiken</i>)	Loans with lending terms that have been changed in ways favorable to the borrower, including reducing interest rates, providing grace periods for repayment and forgiving a portion of the debt.

Reserve Policies

Claims against obligors, as categorized under self-assessment guidelines	Reserve policy
Claims against virtually and legally bankrupt obligors	We either write off directly or make a provision for, in the specific reserve for loan losses, the full amount of the unsecured, unguaranteed portion of the claim.
Claims against possibly bankrupt obligors	For most claims against possibly bankrupt obligors, we make a provision in the specific reserve for loan losses in an amount calculated based on the discounted cash flow method. See "Reserve for Credit Losses." For the remaining claims, we make a provision to that reserve for the unsecured, unguaranteed portion of the claims in the amount of the product of that portion and the higher of 70% or the estimated loss ratio, based on historical losses on claims in this category, for the next three years.
Claims against substandard obligors	For most claims against substandard obligors, we make a provision in the general reserve for loan losses in an amount calculated based on the discounted cash flow method. See "Reserve for Credit Losses." For the remaining claims, we make a provision to that reserve for the estimated amount of losses over three years computed based on the expected loss ratio for claims in this category.
Claims against caution obligors, other than claims against substandard obligors	We make a provision, in the general reserve for loan losses, for the estimated amount of losses over the average remaining term of the loans computed based on the expected loss ratio for claims in this category.
Claims against normal obligors	For claims against obligors rated 5A through 6C under our credit rating system and all real estate non-recourse loans, we make a provision, in the general reserve for loan losses, for the estimated amount of losses over the remaining term of the loans computed based on the expected loss ratio for claims in this category. For the remaining claims, we make a provision to that reserve for the estimated amount of losses over a year computed based on the expected loss ratio for claims in this category.

Claims Classified Under the Financial Revitalization Law

Under the Financial Revitalization Law, Japanese banks categorize their total claims in four categories by reference to the nature of the relevant assets. In addition to loans and bills discounted, claims that are subject to disclosure under the Financial Revitalization Law include foreign exchange claims, securities lent, accrued income and suspense payment in other assets, as well as customers' liabilities for acceptances and guarantees.

Disclosure of Claims Classified Under the Financial Revitalization Law

Our current management team has consistently emphasized the monitoring and reduction of problem loans. Shinsei's total amount of problem claims as disclosed pursuant to the Financial Revitalization Law decreased ¥9.2 billion, or 17.9%, to ¥42.5 billion, between March 31, 2005 and 2006. During the fiscal year ended March 31, 2006, claims against bankrupt and quasi-bankrupt obligors and doubtful claims continued to decrease: claims against bankrupt and quasi-bankrupt obligors decreased from ¥3.1 billion to ¥0.7 billion, and doubtful claims decreased 50.8% to ¥20.7 billion. Substandard claims, however, increased during fiscal year 2005 from ¥6.4 billion to ¥21.0 billion as a result of our self-assessment. The ratio of non-performing claims disclosed under the Financial

Revitalization Law to total non-consolidated claims as of March 31, 2006 decreased slightly to 1.0%, compared to 1.4% as of March 31, 2005.

Shinsei's other claims against caution obligors, excluding substandard claims, totaled ¥76.8 billion as of March 31, 2006, a 6.8% increase from ¥71.9 billion as of March 31, 2005. These claims represented 1.9% of total non-consolidated claims as of March 31, 2006, down from 2.0% as of March 31, 2005. The reductions of our non-performing loans we have achieved are attributable to the following processes to identify, manage and resolve problem loans effectively:

- first, we rigorously apply our ratings and self-assessment procedures to label each obligor and loan consistently and accurately; and
- second, for obligors with relatively low credit quality, particularly those whose financial situation is unstable, we commence early remedial consultation and action, including collections and sale of collateral. We closely review various options, including company restructuring and securitization, which can improve or reduce credit risk, before deciding on a final course of action.

The tables and graph below show the reduction in the balance of our non-performing loans on a non-consolidated basis:

Table 17. Claims Classified Under the Financial Revitalization Law (Non-Consolidated)

As of March 31	Billions of yen (except percentages)	
	2006	2005
Claims against bankrupt and quasi-bankrupt obligors	¥ 0.7	¥ 3.1
Doubtful claims	20.7	42.1
Substandard claims	21.0	6.4
Total claims disclosed under the Financial Revitalization Law ⁽¹⁾	42.5	51.7
Normal claims and claims against caution obligors excluding substandard claims	4,086.4	3,569.3
Total claims	¥4,129.0	¥3,621.0
Ratio of total claims disclosed under the Financial Revitalization Law to total claims	1.0%	1.4%

Note:

(1) Total claims disclosed under the Financial Revitalization Law includes loans and bills discounted, customers' liabilities for acceptances and guarantees and other exposure to or in respect of bankrupt and quasi-bankrupt obligors and doubtful claims, as well as loans and bills discounted classified as substandard claims.

Coverage Ratios

As of March 31, 2006 Shinsei's non-consolidated coverage ratios for claims classified under the Financial Revitalization Law, which for each category of claims is the total of collateral pledged against claims, guarantees for claims and reserve for loan losses, measured against total claims, were 100.0% for claims against bankrupt and quasi-bankrupt obligors, 90.5% for doubtful claims and 63.8% for substandard claims. For all claims classified under the Law, the coverage ratio was 77.4%, a decrease from 94.3% as of

March 31, 2005 as a result of the upgrading of certain claims with high coverage ratios and the increase of claims disclosed with low coverage ratios.

Shinsei directly writes off, rather than reserves, the portion of claims against virtually and legally bankrupt obligors that are estimated to be uncollectible. In the fiscal years ended March 31, 2006 and 2005, ¥2.4 billion and ¥5.9 billion, respectively, of such claims were written off on a non-consolidated basis.

Table 18. Coverage Ratios for Non-Performing Claims Disclosed Under the Financial Revitalization Law (Non-Consolidated)

	Billions of yen (except percentages)				Coverage ratio
	Amount of claims	Amounts of coverage		Total	
		Reserve for loan losses	Collateral and guarantees		
As of March 31, 2006:					
Claims against bankrupt and quasi-bankrupt obligors	¥ 0.7	¥ —	¥ 0.7	¥ 0.7	100.0%
Doubtful claims	20.7	17.7	1.0	18.7	90.5
Substandard claims	21.0	7.7	5.7	13.4	63.8
Total	¥ 42.5	¥25.4	¥ 7.4	¥ 32.9	77.4%
As of March 31, 2005:					
Claims against bankrupt and quasi-bankrupt obligors	¥ 3.1	¥ —	¥ 3.1	¥ 3.1	100.0%
Doubtful claims	42.1	30.3	9.5	39.8	94.6
Substandard claims	6.4	2.7	3.0	5.8	89.5
Total	¥ 51.7	¥33.0	¥15.7	¥ 48.8	94.3%

Disposal of Problem Claims

Shinsei uses a variety of methods for removing problem loans from its balance sheet, including sales, collections and, prior to the third anniversary of the closing date of the acquisition of LTCB, the return of loans to the DIC pursuant

to our cancellation right. The following table sets forth a breakdown of disposals of substandard claims, doubtful claims and claims against bankrupt and quasi-bankrupt obligors on a non-consolidated basis:

Table 19. Reduction of Problem Claims as Disclosed Under the Financial Revitalization Law (Non-Consolidated)

Fiscal years ended March 31	Billions of yen	
	2006	2005
Write-off/forgiveness	¥1.5	¥ 2.7
Sale	3.8	8.3
Transferred to DIC via exercise of cancellation right	—	2.3
Collections, net	3.9	32.0
Total	¥9.2	¥45.5

Loans with respect to which we exercised our cancellation right remained on our balance sheet, and were reflected as appropriate in our problem loan disclosure, until the loans were actually transferred to the DIC. All disputes regarding exercise of the cancellation right with the

DIC were resolved in the fiscal year ended March 31, 2005.

In the fiscal year ended March 31, 2006, Shinsei reduced non-performing claims by ¥9.2 billion. Of the total decline, 42.2% or ¥3.9 billion was attributable to collections or improvement of obligor's credit.

Changes in Amount of Problem Claims

The table below sets forth Shinsei's experience since March 31, 2004 with the removal of problem claims and the emergence of new claims over recent periods on a non-consolidated basis:

Table 20. Changes in Amount of Problem Claims (Non-Consolidated)

As of March 31	Billions of yen			
	Substandard claims	Doubtful claims	Claims against bankrupt and quasi-bankrupt obligors	Total
Balance of problem claims as of March 31, 2004	¥ 17.2	¥ 68.8	¥ 11.1	¥ 97.3
Claims newly added April 1 to March 31, 2005	0.0	6.5	0.9	7.5
Claims removed April 1 to March 31, 2005	(10.2)	(32.2)	(10.5)	(53.0)
Claims migrating between classifications April 1 to March 31, 2005	(0.5)	(1.0)	1.6	—
Net change	(10.7)	(26.7)	(8.0)	(45.5)
Balance of problem claims as of March 31, 2005	¥ 6.4	¥ 42.1	¥ 3.1	¥ 51.7
Claims newly added April 1 to March 31, 2006	18.8	3.2	0.6	22.7
Claims removed April 1 to March 31, 2006	(4.2)	(24.6)	(3.1)	(32.0)
Claims migrating between classifications April 1 to March 31, 2006	0.0	(0.0)	0.0	—
Net change	14.6	(21.4)	(2.4)	(9.2)
Balance of problem claims as of March 31, 2006	¥ 21.0	¥ 20.7	¥ 0.7	¥ 42.5

In the fiscal year ended March 31, 2006, ¥22.7 billion of claims were newly classified as substandard or worse, while Shinsei removed ¥32.0 billion of claims in these categories during the same period. The ¥24.6 billion in doubtful claims removed during the period was primarily attributable to collections and upgrading of claims to a higher category.

For the fiscal year ended March 31, 2005, only ¥7.5 billion of claims were newly classified as substandard or worse, while Shinsei removed ¥53.0 billion of claims in these categories during the same period. The ¥32.2 billion in doubtful claims removed during the fiscal year ended March 31, 2005 was principally attributable to collections, as well as sales to third parties other than the DIC.

Reserve for Credit Losses

The following table sets forth a breakdown of our total reserve for credit losses on a non-consolidated basis as of the dates indicated:

Table 21. Reserve for Credit Losses (Non-Consolidated)

As of March 31	Billions of yen (except percentages)	
	2006	2005
General reserve for loan losses	¥ 60.2	¥ 56.1
Specific reserve for loan losses	17.9	35.7
Reserve for loans to restructuring countries	0.0	0.0
Subtotal reserve for loan losses	78.1	91.9
Specific reserve for other credit losses	33.2	32.5
Total reserve for credit losses	¥ 111.4	¥ 124.4
Total claims ⁽¹⁾	¥4,129.0	¥3,621.0
Ratio of total reserve for loan losses to total claims	1.9%	2.5%
Ratio of total reserves for credit losses to total claims	2.7%	3.4%

Note:

(1) Total claims includes loans and bills discounted, foreign exchange claims, securities lent, accrued interest income and suspense payment in other assets, as well as customers' liabilities for acceptances and guarantees.

As of March 31, 2006 and March 31, 2005, our total reserve for credit losses on a non-consolidated basis was ¥111.4 billion and ¥124.4 billion, constituting 2.7% and 3.4%, respectively, of total claims as of each such date.

In the fiscal year ended March 31, 2006, Shinsei applied the discounted cash flow method to 76.6% of its claims against possibly bankrupt obligors and 95.2% of its claims against substandard obligors, in each case by principal amount.

Risk-Monitored Loans

Consolidated risk-monitored loans increased by 5.2% during the fiscal year ended March 31, 2006 to ¥84.1 billion. The ¥11.8 billion decrease in non-accrual delinquent loans was more than offset by a ¥19.2 billion increase in restructured loans to ¥42.8 billion as of March 31, 2006. The increase was due to newly added sub-standard claims downgraded from upper categories.

The following tables set forth information concerning our consolidated and non-consolidated risk-monitored loans as of the dates indicated:

Table 22. Risk-Monitored Loans (Consolidated)

As of March 31	Billions of yen (except percentages)	
	2006	2005
Loans and bills discounted	¥4,087.5	¥3,430.4
Loans to bankrupt obligors (A)	1.8	2.6
Non-accrual delinquent loans (B)	36.3	48.1
Total (A) + (B)	¥ 38.2	¥ 50.8
Ratio to total loans and bills discounted (%)	0.9%	1.5%
Loans past due for three months or more (C)	¥ 3.1	¥ 5.5
Restructured loans (D)	42.8	23.6
Total risk-monitored loans (A) + (B) + (C) + (D)	¥ 84.1	¥ 80.0
Ratio to total loans and bills discounted (%)	2.1%	2.3%
Reserve for credit losses	¥ 144.8	¥ 149.7

Table 23. Risk-Monitored Loans (Non-Consolidated)

As of March 31	Billions of yen (except percentages)	
	2006	2005
Loans and bills discounted	¥3,961.2	¥3,443.7
Loans to bankrupt obligors (A)	0.5	2.3
Non-accrual delinquent loans (B)	20.4	41.2
Total (A) + (B)	¥ 21.0	¥ 43.5
Ratio to total loans and bills discounted (%)	0.5%	1.3%
Loans past due for three months or more (C)	¥ 0.0	¥ 3.1
Restructured loans (D)	21.0	3.3
Total risk-monitored loans (A) + (B) + (C) + (D)	¥ 42.1	¥ 50.0
Ratio to total loans and bills discounted (%)	1.1%	1.5%
Reserve for credit losses	¥ 111.4	¥ 124.4

Other assets on our consolidated balance sheet as of March 31, 2006 also include ¥1.3 billion of installment receivables to bankrupt obligors and ¥3.6 billion of non-accrual delinquent installment receivables, ¥1.3 billion of past due for three months or more installment receivables and ¥16.2 billion of restructured installment receivables, which are not included in our balance of consolidated risk-monitored loans as of that date.

Asset Quality of APLUS and Showa Leasing

APLUS and Showa Leasing classify their obligors and assess their asset quality on a semi-annual basis based on the self-

assessment manual developed in accordance with guidelines published by the FSA. APLUS and Showa Leasing's assessment, where applicable, include, among other things, an assessment of credit extended to credit card customers as well as lease obligors, unsecured personal loans and customer guarantees.

The following tables set forth information concerning consolidated risk-monitored loans and risk-monitored installment receivables held by Shinsei, APLUS, Showa Leasing and other subsidiaries as of the dates indicated:

Table 24. Risk-Monitored Loans Breakdown for Large Entities (Consolidated)⁽¹⁾

	Billions of yen			
	Shinsei	APLUS	Other subsidiaries	Total
As of March 31, 2006:				
Loans to bankrupt obligors	¥ 0.5	¥ —	¥ 1.3	¥ 1.8
Non-accrual delinquent loans	20.4	4.4	11.4	36.3
Loans past due for three months or more	0.0	2.9	0.1	3.1
Restructured loans	21.0	21.2	0.4	42.8
Total	¥42.1	¥28.7	¥13.3	¥84.1
As of March 31, 2005:				
Loans to bankrupt obligors	¥ 2.3	¥ 0.0	¥ 0.2	¥ 2.6
Non-accrual delinquent loans	41.2	4.2	2.6	48.1
Loans past due for three months or more	3.1	2.4	—	5.5
Restructured loans	3.3	19.9	0.3	23.6
Total	¥50.0	¥26.6	¥ 3.2	¥80.0

Note:

(1) Showa Leasing has no such loans.

Table 25. Risk-Monitored Installment Receivables included in Other Assets (Consolidated)⁽¹⁾

	Billions of yen			
	APLUS	Showa Leasing	Other subsidiaries	Total
As of March 31, 2006:				
Credits to bankrupt obligors	¥ —	¥1.2	¥0.0	¥ 1.3
Non-accrual delinquent credits	2.0	0.8	0.7	3.6
Credits past due for three months or more	0.9	0.0	0.3	1.3
Restructured credits	15.5	0.4	0.2	16.2
Total	¥18.5	¥2.5	¥1.5	¥22.5
As of March 31, 2005:				
Credits to bankrupt obligors	¥ 0.6	¥0.7	¥0.0	¥ 1.4
Non-accrual delinquent credits	3.4	0.1	0.6	4.2
Credits past due for three months or more	0.7	0.0	0.2	1.0
Restructured credits	17.8	0.4	0.0	18.2
Total	¥22.5	¥1.3	¥1.0	¥25.0

Note:

(1) Shinsei has no such installment receivables.

Funding and Liquidity

Funding and Liquidity Management

The focus of liquidity management is to ensure sufficient cash to meet both normal and unanticipated funding needs. Successful liquidity management requires being able to fund all requirements without disruption to our normal business operations. Funding requirements may include contractual obligations, future asset growth, liability maturities and deposit withdrawals.

Our liquidity management strategy includes the following key components:

- maintaining a portfolio of surplus cash and liquid assets;
- developing retail customer deposits as a long-term, stable source of funding;
- maintaining unutilized funding capacity; and
- maintaining diverse sources of funding.

We continuously seek to improve our liquidity management strategy and minimize refinancing risk by enhancing the stability and diversity of our funding sources. Our Treasury Division is responsible for our liquidity management and funding execution.

In accordance with its role as a special purpose long-term credit bank in Japan, LTCB relied heavily on domestic debentures for funding. Over the past six years, however, we

have transformed ourselves into a full-service financial institution and as part of that process have increased our retail deposit balances. We formally converted from a long-term credit bank to an ordinary bank on April 1, 2004. In connection with this conversion, the FSA has allowed us to continue issuing debentures for ten years after the conversion. Our long-term funding strategy, however, is to eventually replace debenture issuances with customer deposits and ordinary debt financing.

Shinsei provides funding to its subsidiaries and affiliates, and expects to continue to do so. However, our subsidiaries and affiliates may rely on other sources of funds, including financing from other banks as well as capital markets financing, where doing so would be sound from a cost and group cash management perspective. In particular, APLUS and Showa Leasing borrow, and expect to continue to borrow, from a number of banks other than Shinsei and also make direct issuances of debt securities.

The table below shows changes in the proportion of our funding overall represented by funds raised from debentures and deposits in our retail and institutional banking businesses, as well as from our collateralized loan obligation program at the end of the periods indicated. As seen below, funds from retail deposits have become an increasingly important source of funding.

Table 26. Diversification by Funding Type (Consolidated)⁽¹⁾

Fiscal year ended March 31	Billions of yen			
	2006	2005	2004	2003
Retail deposits ⁽²⁾	¥3,103.4	¥2,300.4	¥1,591.5	¥1,492.1
Retail debentures	435.3	559.3	645.2	701.5
Institutional funding ⁽³⁾	1,551.8	1,835.7	1,855.6	2,267.4
Collateralized loan obligation	255.0	255.0	255.2	300.2

Notes:

(1) Excludes unclaimed matured debentures.

(2) Includes wealth management customers' deposits.

(3) Previous years have been restated to exclude corporate bonds from institutional funding.

Deposits

As of March 31, 2006, we had deposits, including negotiable certificates of deposit, of ¥4,071.7 billion, which constituted 49.1% of total liabilities and represented a 17.9% increase compared with March 31, 2005. In particular, retail deposits increased ¥803.0 billion in the fiscal year ended March 31, 2006, reflecting both the successful implementation of our strategy to place greater emphasis on deposits in funding, as well as the continued growth of our retail banking business.

Most of our deposits and all of our negotiable certificates of deposit are from domestic corporate and retail customers. Of the ¥803.0 billion total, yen retail deposits increased by ¥815.4 billion in the fiscal year ended March 31, 2006, reflecting continued growth of our retail banking business. The foreign currency deposits of our retail customers decreased by ¥12.3 billion in the fiscal year ended March 31, 2006.

The following table sets forth the composition of our time deposits, all of which paid fixed interest rates in the fiscal years ended March 31, 2006, and 2005, by remaining maturity as of the dates indicated:

Table 27. Time Deposits by Maturity (Consolidated)

As of March 31	Billions of yen	
	2006	2005
Less than three months ⁽¹⁾	¥ 317.4	¥ 268.5
Three months or more, but less than six months	223.4	165.9
Six months or more, but less than one year	385.0	104.7
One year or more, but less than two years	318.7	334.0
Two years or more, but less than three years	42.2	315.3
Three years or more	1,049.2	597.1
Total	¥2,336.2	¥1,785.8

Note:

(1) Less than three months includes time deposits that have matured but have not yet been paid.

Debentures

As of March 31, 2006, we had ¥1,018.9 billion in debentures outstanding. This represented 12.3% of our consolidated total liabilities and constituted a decline of 18.0%

from March 31, 2005. Debentures are issued with terms of one, two, three or five years.

As of March 31, 2006, scheduled repayments of debentures over the periods indicated below were as follows:

Table 28. Maturity Schedule of Debentures (Consolidated)

Fiscal year ending March 31	Billions of yen
2007	¥ 384.7
2008	139.8
2009	168.2
2010	144.4
2011 and thereafter	181.6
Total	¥1,018.9

While we will continue to issue debentures where we are able to minimize funding costs, we will also continue diversifying our funding sources by raising funds through other means, such as deposits.

Other

The securitization of loans and other assets is another important component of our funding strategy. In the fiscal year ended March 31, 2002, we established a collateralized loan obligation program under which we receive the net proceeds from the issuance of notes that are backed by interests in loans we transferred to a master trust. As of

March 31, 2006, there were ¥255.0 billion in such asset-backed notes outstanding that were issued to third-party investors and accordingly the corresponding assets were removed from our balance sheet. We intend to continue to use securitization, particularly our collateralized loan obligation program, as one component of our overall funding strategy. See "Off-Balance Sheet Arrangements—Collateralized Loan Obligation Program."

We also have established a medium-term note program, under which we can issue up to \$5.0 billion in notes of varying terms. As of March 31, 2006, there were ¥20.0 billion of notes outstanding under the program.

Credit Ratings

Our borrowing costs and ability to raise funds are impacted directly by our credit ratings and changes thereto. Shinsei's credit ratings are set forth in the table below:

Table 29. Shinsei's Credit Ratings as of March 2006

Rating agency	Long-term	Short-term
Moody's	Deposits: A3 Senior debt: A3	P-2
Standard & Poor's	BBB+	A-2
Fitch	BBB+	F2
R&I	A-	—
JCR	A-	—

Our current ratings as of March 2006 reflect rating upgrades given to Shinsei by Moody's and Fitch during the current fiscal year. In December 2005, R&I, and in January 2006, Standard & Poor's, each upgraded its outlook on Shinsei from "stable" to "positive." On February 3, 2006, Moody's announced that it upgraded Shinsei's long-term credit rating from Baa1 to A3. We believe these upgrades and change of outlook will reduce our funding costs and facilitate our liquidity risk management.

Asset Liability Management

Our ALM Committee is responsible for reviewing and approving liquidity and interest rate risk policies and limits. Our president is the chairman of the committee. Other members include group heads and general managers of divisions whose operations are closely related to balance sheet management. Our president retains final decision-making authority over policy relating to asset and liability management.

Asset Liability Management Methodology—Interest Rate Risk

We take an integrated approach to manage interest rate risk, incorporating both on-balance sheet transactions, such as lending activities, and off-balance sheet transactions, such as swaps. We analyze and manage risk both in terms of fair market value and profit or loss for a given accounting period.

We set limits for fair market value risk according to the basis point value, or bpv, method, whereby risk arising from interest rate fluctuation is restricted to a predetermined proportion of our shareholders' equity.

For profit or loss within a specific period, risk limits are set based on net interest income. Our future balance sheet is estimated by constructing a hypothetical model that includes expected rollover of lending and deposits, together with information from our current balance sheet and operational plans. Net interest income simulations are carried out using various statistically generated scenarios for market interest rate fluctuations. Based on these calculations, fluctuations of net interest income over a year are restricted to a predetermined range, with the objective of stabilizing interest income and expenses. We manage our assets and liabilities, including the mixture of fixed and variable-rate assets and liabilities, accordingly.

Bpv Method

The bpv method measures the risk of changes in fair market value due to fluctuations in interest rates. For example, 10 bpv means the change of fair market value when interest rates move 10 basis points, or 0.1%. The table below sets forth the impact on the value of our on-balance sheet and off-balance sheet items for the maturities shown when interest rates move 10 basis points.

Table 30. Impact of a 10 Basis Point Movement on Fair Market Value (Non-Consolidated)

As of March 31, 2006	Billions of yen					Total
	Three months or less	Six months or less	Over six months to one year	Over one year to three years	Over three years	
On-balance sheet	¥0.1	¥(0.0)	¥(0.2)	¥(0.8)	¥0.5	¥(0.5)
Off-balance sheet	(0.0)	(0.0)	0.0	0.0	1.3	1.3
Total	¥0.0	¥(0.1)	¥(0.2)	¥(0.8)	¥1.8	¥ 0.7

Note: Positive figures indicate where a decline in interest rates will result in an increase in fair market value. Negative figures indicate where a decline in interest rates will result in a decrease in fair market value.

Contractual Cash Obligations

We use contractual cash obligations for funding purposes. The following table sets forth a summary of our primary consolidated contractual cash obligations as of March 31, 2006 and March 31, 2005:

Table 31. Contractual Cash Obligations (Consolidated)

Payments due by period as of March 31, 2006	Billions of yen		
	One year or less	Over one year	Total
Borrowed money	¥509.5	¥696.2	¥1,205.7
Capital lease obligations	0.7	1.3	2.1
Total	¥510.3	¥697.6	¥1,207.9

Payments due by period as of March 31, 2005	Billions of yen		
	One year or less	Over one year	Total
Borrowed money	¥502.5	¥657.7	¥1,160.2
Capital lease obligations	0.7	1.9	2.7
Total	¥503.3	¥659.6	¥1,162.9

Taxation

Schedule of Tax Loss Carryforwards

Our tax loss carryforwards principally have resulted from the realization of credit losses for tax purposes since our emergence from temporary nationalization. As of March 31, 2006, Shinsei had ¥217.6 billion in tax loss carryforwards. Tax reforms implemented in the fiscal year ended March 31, 2004 extended the period of tax loss carryforwards from five years to seven years. As this extension was applied

retroactively for the three previous tax years, the expiry dates for our tax loss carryforwards generated in the fiscal years ended March 31, 2002 and 2003 have been extended to March 31, 2009 and 2010, respectively. We believe this amendment is beneficial to us as it provides more time to utilize these tax loss carryforwards. The table below sets forth a schedule of tax loss carryforwards related to corporate tax and their expiration dates:

Table 32. Schedule of Tax Loss Carryforwards (Non-Consolidated)

Year tax loss carryforward generated/renewed	Billions of yen	
	Amount	Date of expiry
Fiscal year ended March 31, 2002	¥ 63.0	March 31, 2009
Fiscal year ended March 31, 2003	154.5	March 31, 2010
Total	¥217.6	

So long as APLUS and Showa Leasing are not wholly owned subsidiaries, we will be unable to include their results as part of our consolidated tax returns. As a result, their tax losses are not reflected in the table above. The table below sets forth a schedule of tax loss carryforwards of APLUS and Showa Leasing as of March 31, 2006.

Year tax loss carryforward generated/renewed	Billions of yen	
	Amount	Date of expiry
APLUS		
Fiscal period ended March 31, 2005	¥157.7	March 31, 2012
Fiscal period ended September 30, 2005	2.9	March 31, 2013
Fiscal period ended March 31, 2006	4.6	March 31, 2013
Showa Leasing		
Fiscal year ended March 31, 2005	¥32.2	March 31, 2012

In the event that Shinsei, APLUS or Showa Leasing, as the case may be, generates less taxable income in a given fiscal year than the tax loss carryforward that will expire at year-end, the benefit of the unused portion of the expiring tax loss carryforward will be lost.

We record deferred tax assets for tax loss carryforwards and evaluate them in accordance with the JICPA guidelines. See "Critical Accounting Policies—Valuation of Deferred Tax Assets."

Table 33. Shareholders' Equity

As of March 31	Millions of yen (except percentages)	
	2006	2005
Common stock	¥180,853	¥180,853
Preferred stock	270,443	270,443
Capital surplus	18,558	18,558
Retained earnings	379,502	311,039
Net unrealized gain on securities available-for-sale, net of taxes	2,208	3,043
Foreign currency translation adjustments	3,781	2,738
Treasury stock, at cost	(12)	(9)
Total shareholders' equity	¥855,335	¥786,667
Ratio of total shareholders' equity to total assets	9.1%	9.2%

The primary reason for recent increases in our shareholders' equity has been increases in retained earnings due to our profitable operations. Shareholders' equity is also adjusted for net unrealized gains on securities available-for-sale, net of taxes. Total shareholders' equity as of March 31, 2006 increased by ¥68.6 billion, or 8.7%, compared to March 31, 2005 due primarily to an increase in retained earnings.

Capital Ratios

The FSA's bank capital guidelines are based on the risk-adjusted approach developed by the Basel Committee on Banking Regulations and Supervisory Practices of the Bank for International Settlements. The FSA's guidelines are similar to those issued by other central bank regulators and the differences reflect the FSA's implementation of the BIS's approach in a manner designed to suit the Japanese

Consolidated Corporation Tax System

We file our tax returns under the consolidated corporation tax system from the fiscal year ended March 31, 2004.

Under the consolidated system, we base corporate tax payments on the combined profits or losses of Shinsei and its wholly owned domestic subsidiaries.

Capital Resources and Adequacy

Shareholders' Equity

The following table sets forth a summary of our shareholders' equity as of March 31, 2006 and 2005:

banking environment. We continuously monitor our risk-adjusted capital ratios and manage our operations in light of the capital ratio requirements.

Our total capital adequacy ratio as of March 31, 2006 was 15.53%, compared with 11.78% as of March 31, 2005. Our Tier I capital ratio, or the ratio of Tier I capital to risk assets, also increased from 7.00% as of March 31, 2005 to 10.27% as of March 31, 2006. The increases in the capital ratios at March 31, 2006 reflect fiscal year 2005 net income as well as our issuances of hybrid Tier I perpetual preferred securities and Tier II callable subordinated notes. These increases were partly offset by repayment of existing more expensive subordinated debt and bonds. The amount of our net deferred taxes, or the difference between our deferred tax assets and our deferred tax liabilities, was 2.2% of our Tier I capital as of March 31, 2006.

Table 34. Consolidated Capital Ratios

As of March 31	Billions of yen (except percentages)	
	2006	2005
Basic items (Tier I):		
Capital stock	¥ 451.2	¥ 451.2
Minority interests in consolidated subsidiaries	183.8	4.3
Consolidation goodwill and other intangibles	(294.8)	(321.2)
Total Tier I (A)	738.1	463.0
Supplementary items (Tier II):		
General reserve for loan losses	44.8	41.3
Perpetual preferred stocks	78.0	49.5
Perpetual subordinated debt and bonds	22.5	196.8
Non-perpetual subordinated debt and bonds	274.1	51.0
Total	¥ 419.5	¥ 338.6
Amount eligible for inclusion in capital (B)	¥ 419.5	¥ 338.6
Deduction (C)	42.2	22.7
Total capital (D) [(A) + (B) – (C)]	¥1,115.3	¥ 778.9
Risk assets:		
On-balance sheet items	¥5,344.9	¥4,624.6
Off-balance sheet items	1,835.5	1,986.2
Total (E)	¥7,180.4	¥6,610.9
Consolidated capital adequacy ratio (D) / (E)	15.53%	11.78%
Consolidated Tier I capital ratio (A) / (E)	10.27	7.00

Composition of Tier I Capital

Common stock and retained earnings. In conjunction with the sale of our common shares by the DIC to New LTCB Partners, the DIC contributed funds to offset the existing deficit in the accounts of LTCB and new shares of common stock were acquired by New LTCB Partners. Following this recapitalization, our shareholders' equity includes common stock in the amount of ¥180.8 billion. As a result of our recording net income in each of the past six fiscal years, retained earnings have grown to ¥379.5 billion as of March 31, 2006.

Preferred stock. Shinsei has issued two classes of preferred stock. All shares of Class A preferred stock were initially issued to the RCC by LTCB. Upon LTCB's

nationalization, the RCC transferred those shares to the DIC. At the time of sale of LTCB's common shares to New LTCB Partners in March 2000, a portion of the Class A preferred shares was redeemed without any consideration paid and cancelled. The DIC continues to own the remaining 74,528,000 shares. At the same time, Shinsei issued 600,000,000 new shares of Class B preferred stock to the RCC.

As holders of our preferred shares, the DIC and the RCC are entitled to receive annual dividends and distribution of residual assets of Shinsei as set out below in priority to holders of common shares but *pari passu* among themselves:

Table 35. Dividends and Distribution Amounts on Shares of Preferred Stock

Class of preferred shares	Yen per share	
	Amount of annual dividend	Amount of distribution of residual assets
Class A preferred shares	¥13.00	¥1,300
Class B preferred shares	4.84	400

Shinsei may pay up to one-half of the annual dividend payable on each class of preferred shares as an interim dividend. Dividends on the preferred shares are not cumulative. As long as the preferred dividend is paid, holders of

preferred shares are not entitled to vote at a general meeting of shareholders. If the preferred dividend is not paid, preferred shares vote on a one-to-one basis with common shares on all matters.

The Class A preferred shares are convertible into common shares at the option of the holder at a conversion price of ¥360 per share. They are mandatorily convertible on April 1, 2008, at the number of common shares calculated by dividing ¥1,300 by the average market price per common share during a certain period preceding April 1, 2008, with a maximum of two common shares per Class A preferred share.

The Class B preferred shares are convertible at the option of the holder at a conversion price of ¥599.90 per share. The conversion price will be adjusted on August 1, 2006 and 2007 based on the average market price per share during a certain period preceding August 1, 2006 or 2007, as applicable (or, if the common shares are no longer publicly traded, the total amount of shareholders' equity, excluding preferred stock, per diluted common share). At no time, however, shall the conversion price be less than ¥599.90 or more than ¥799.90. The Class B preferred shares are mandatorily convertible on August 1, 2007.

Other material terms of the preferred shares are set forth in Note 24 to the Consolidated Financial Statements. Holders of our preferred shares have no redemption rights, but it is possible we would seek to redeem the preferred shares in order to increase our flexibility in managing our business.

Preferred Securities Issued by Subsidiaries outside Japan

On February 23, 2006, we issued \$775.0 million of step-up non-cumulative perpetual preferred securities. The dividend on the preferred securities is 6.418% for the initial ten years. In addition, on March 23, 2006 we issued \$700.0 million of non-cumulative non-step-up perpetual preferred securities. The dividend on the non-step-up perpetual preferred securities is 7.16% for the initial ten years. These issuances are consistent with our strategy to

strengthen our Tier I capital ratio and have enhanced our Tier I ratio by over 2%. The proceeds from the offering of the preferred securities are recorded as minority interests in consolidated subsidiaries and counted towards Tier I capital. The amount of such proceeds which may be counted towards Tier I capital is constrained by the amount of other Tier I capital outstanding. Our ability to raise additional regulatory capital in this manner could be constrained in the future.

Composition of Tier II Capital

The principal component of our Tier II capital is subordinated debt and bonds. On February 23, 2006, we issued €1.0 billion of step-up callable subordinated notes bearing interest at a fixed rate of 3.75% for the initial five years. The issuance was consistent with our strategy to strengthen our capital ratios and replace expensive Upper Tier II subordinated debt with lower cost capital. As of March 31, 2006, we had ¥100.0 billion of dated subordinated bonds issued by Shinsei and ¥46.0 billion in subordinated debt from private lenders, which were included in Tier II, ¥15.0 billion of which were perpetual loans. None of our Tier II capital now consists of public funds.

Other elements of our Tier II capital are general reserve for loan losses and ¥78.0 billion of class D perpetual preferred shares of APLUS held by third parties as of March 31, 2006. Tier II capital is subject to the limitation that it cannot exceed the amount of Tier I capital. Subject to that ceiling, the entire amount of perpetual subordinated debt and bonds can be included in Tier II capital.

The table below sets forth the amount of our subordinated debt and bonds, as well as the portion included in our Tier II capital:

Table 36. Subordinated Debt and Bonds (Consolidated)

	Billions of yen					
	Perpetual	Perpetual included in Tier II	Non-perpetual	Non-perpetual included in Tier II	Total	Total included in Tier II
As of March 31, 2006						
Subordinated debt	¥113.0	¥15.0	¥ 31.0	¥ 31.0	¥144.0	¥ 46.0
Subordinated bonds	18.4	7.5	243.8	243.1	262.2	250.6
Total	¥131.4	¥22.5	¥274.8	¥274.1	¥406.2	¥296.6
As of March 31, 2005						
Subordinated debt	¥175.0	¥175.0	¥ —	¥ —	¥175.0	¥175.0
Subordinated bonds	21.8	21.8	51.0	51.0	72.8	72.8
Total	¥196.8	¥196.8	¥51.0	¥51.0	¥247.8	¥247.8

During the fiscal year ended March 31, 2006, we repaid ¥77.0 billion of perpetual subordinated debt and ¥10.9 billion of perpetual subordinated bonds and raised newly ¥15.0 billion of perpetual subordinated debt and ¥7.0 billion of perpetual subordinated bonds. In addition, we repaid ¥96.0 billion of perpetual subordinated debt and ¥4.0 billion of perpetual subordinated bonds in April 2006 and expect to repay an additional ¥2.0 billion of perpetual subordinated debt and ¥6.9 billion of perpetual subordinated bonds by September 2006. These perpetual subordinated debt and bonds which were paid or will be paid during the fiscal year ending March 31, 2007 were deducted from Tier II capital as of March 31, 2006.

Interest rates on ¥22.0 billion of our perpetual subordinated debt and bonds included in Tier II capital as of March 31, 2006 will increase between January 2013 and December 2015. Interest rates on the remaining ¥0.5 billion of perpetual subordinated bonds will increase in December 2008.

¥22.0 billion of our perpetual subordinated debt and bonds included in Tier II capital as of March 31, 2006 will become prepayable between January 2013 and December 2015. The remaining ¥0.5 billion of perpetual subordinated bonds are currently prepayable.

Shinsei issued ¥50.0 billion of dated subordinated bonds on March 25, 2005 for the first time as Shinsei, not LTCB. These dated subordinated bonds cannot be repaid until maturity, on March 25, 2015, and bear interest at a fixed rate of 1.96%. Shinsei issued an additional ¥50.0 billion of dated subordinated bonds on October 31, 2005. These dated subordinated bonds cannot be repaid until maturity, on October 30, 2015, and bear interest at a fixed rate of 2.01%.

Shinsei issued ¥142.8 billion of euro-denominated step-up callable subordinated notes bearing interest at a fixed rate of 3.75% on February 23, 2006. In February, 2011, interest rates on these notes will increase and these notes will become prepayable.

We newly raised ¥31.0 billion of non-perpetual subordinated debt during the fiscal year ended March 31, 2006. Interest rates on ¥3.0 billion of our non-perpetual subordinated debt will increase in March 2011. ¥23.0 billion of our non-perpetual subordinated debt will become prepayable between July 2010 and April 2011 and the remaining ¥8.0 billion of our non-perpetual subordinated debt cannot be repaid until maturity.

Off-Balance Sheet Arrangements

We use off-balance sheet arrangements, including investments through special purpose entities, securitizations, lines and letters of credit, loan commitments and loan

participations, in the ordinary course of business, including in our securitization and financing businesses, as well as to manage our own liquidity risk. The main purposes of such off-balance sheet arrangements are to develop our institutional banking business as well as to diversify our sources of liquidity. The following is a discussion of the principal off-balance sheet arrangements we use.

Securitization

We structure, arrange, distribute and service mortgage-backed securities and asset-backed securities both for third parties and ourselves. Our securitization services utilize special purpose entities, which may be organized in the forms of trusts, partnerships or corporations, mainly to protect the securitized assets from creditors of transferors even in bankruptcy. Assets securitized include commercial loans, residential mortgage loans, installment receivables and credit-card receivables.

Repackaging

One aspect of our securitization business involves our repackaging of assets purchased by special purpose entities that we establish into new financial instruments that represent undivided interests in the underlying assets. Repackaging the assets generally entails analyzing the cash flows from the underlying assets, using various means to rearrange the timing and order of cash flows, and then combining them with other cash flows to create new financial instruments that can be tailored to meet the demands of a broad range of investors.

Often the assets are repackaged into residual, or subordinated, interests, mezzanine interests and senior interests. The residual interests are the first to suffer any losses as a result of any decline in the value of the underlying financial assets, while the senior interests are structured to be the last to absorb such losses. In instances where we repackage assets on our own initiative, rather than for our customers, we generally retain the residual interests and either sell the senior or mezzanine interests immediately to third parties or hold them temporarily before placing them with investors. Revenues on these transactions consist of gains on sales of the repackaged senior and mezzanine interests, transaction arrangement fees received from the originators of the assets, fees for underwriting the senior instruments, and returns on the residual interests.

The principal risk inherent in these repackagings is credit risk on the securitized financial instruments that is absorbed by the retained residual interests. We may record losses on the residual interests due to declines in the value of the underlying financial assets. We manage this credit risk through semiannually assessing our retained interests

and providing valuation allowances for them based on those assessments, taking into consideration how much we believe we will be able to collect on the underlying assets. We generally transfer financial assets to special purpose entities on a "true sale" basis, which means that we would neither be entitled nor required to reacquire the financial assets so transferred.

Arrangement

We also securitize customers' assets on their behalf, drawing on our know-how and experience in establishing securitization vehicles tailored to accommodate clients' needs, analyzing cash flows from the financial assets, structuring them into classes of securitized interests, arranging credit enhancements and locating investors for the securities to be issued. We generally place the securities representing the senior interests from these transactions with third-party investors. We may choose, however, to acquire temporarily a portion of these senior securities for later sale and often structure financial arrangements, including repackaging, that enhance the liquidity of these senior securities in order to attract third-party investors. These securities are recorded in other monetary claims purchased and recorded at fair value.

Our revenue on these transactions consists of fees, generally fixed, for arranging the transaction and for underwriting the sale of the financial instruments. We typically record those fees as having been received at the completion of all arrangements for the customer.

On these transactions, we act as an arranger, an underwriter, a servicer, a trustee or an administrator, or combination of some of these roles, for our corporate customers. As our customers usually retain the residual interests and the related risk of loss on them, we are not exposed to risks of incurring losses inherent in such residual interests.

Residual Interests

As of March 31, 2006 and 2005, we held ¥108.0 billion and ¥149.4 billion, respectively, of debt securities and residual interests from securitization transactions. As of March 31, 2006 and 2005, ¥80.4 billion and ¥93.5 billion of such amounts, respectively, were attributable to securitization transactions of APLUS and ¥4.9 billion and ¥5.0 billion of such amounts, respectively, were attributable to securitization transactions of Life Housing Loan.

Collateralized Loan Obligation Program

In order to diversify our funding sources and enhance our liquidity, we employed the financial engineering skills we developed in our securitization business to securitize our performing loans to corporate customers through a

collateralized loan obligation, or CLO, program.

In the program, which we established in the fiscal year ended March 31, 2002, Shinsei entrusted a part of its performing corporate loans to a "master trust" which was established with Shinsei Trust & Banking Co., Ltd. The master trust then issued several classes of beneficial certificates, each of which represents an undivided economic interest in the underlying loans but differs in "seniority," or the priority in which it receives cash collected from the underlying loans. Shinsei sold the most senior class of certificates to special purpose entities established in order to issue debt securities backed by the certificates; these debt securities were subsequently sold to third-party investors. Shinsei has retained the two subordinated classes of beneficial certificates.

Since the sales of the debt securities backed by senior certificates satisfied criteria for transferring assets under Japanese GAAP, Shinsei derecognized a portion of the corporate loans entrusted to the master trust for the CLO program from its assets by pro rating the carrying amount of such corporate loans by the fair values of all of the beneficial certificates the trust has issued.

Shinsei's retaining the subordinated classes of beneficial certificates enhances the credit of the debt securities backed by the senior certificates, as the subordinated certificates would be the first to be affected by shortfalls in cash collections on the underlying commercial loans due to reasons such as deteriorations in the financial condition of the loan obligors. As a result, however, Shinsei is exposed to credit risk on the commercial loans entrusted to the master trust as the underlying assets for the CLO program.

A significant amount of prepayments on the underlying loans may result in a lack of sufficient cash flows to satisfy future interest or principal payment obligations on the debt securities backed by the senior certificates. In order to manage this risk, Shinsei has structured the debt securities so that they may be amortized ahead of schedule when various conditions are satisfied.

As of March 31, 2006, ¥808.6 billion in loans had been placed in the trust. Also as of that date, beneficial certificates representing ¥352.1 billion of such loans had been issued and remained outstanding, comprising ¥255.0 billion in senior certificates securing notes issued to third-party investors and, as of March 31, 2006, an additional ¥97.1 billion in beneficial certificates retained by Shinsei and recorded in loans and bills discounted. In accordance with our self-assessment procedures and reserve policies, we have provided ¥3.4 billion in the general reserve for loan losses to absorb losses on all of the entrusted loans as of March 31, 2006.

Loan Participations

We have sold or transferred participation interests in certain of our loans. Loan participation involves the original lender under the loans transferring economic interests in the loan to others, while the original lender retains title to the loan itself.

Under Japanese GAAP, where substantially all of the economic interests in and risks of the loans are transferred to the participants, the original lenders are not deemed to bear recourse obligations for the participating interests nor to have any rights to repurchase such interests. As a result, the original lender may remove the loans from its balance sheet as if the loans were sold to the participants. Because substantially all of the economic interest and risks have been transferred to the participants, we believe that we are not taking any substantial economic risk on the portions of loans in which we have sold participating interests.

As of March 31, 2006 and 2005, the total principal amount of participation interests in loans transferred to third parties was ¥124.4 billion and ¥118.1 billion, respectively.

Off-Balance Sheet Arrangements to Extend Credit, Acceptances and Guarantees

We have off-balance sheet commitments to extend credit to customers up to certain predetermined amounts at current market rates, in consideration of which we receive fee income that is recorded on an accrual basis for the period of the commitments. As of March 31, 2006 and 2005, we had ¥4,092.7 billion and ¥3,277.6 billion of these commitments, of which ¥3,922.1 billion and ¥3,095.2 billion

had agreement terms of less than one year, respectively.

In addition, we provide acceptances and guarantees, which include lines and letters of credit and guarantees on customers' borrowings from other creditors. These acceptances and guarantees require us to satisfy our customers' obligations in the event they fail to do so, although we would have a claim for reimbursement against them. Under Japanese GAAP for banks, these commitments are deemed to be both contingent assets and liabilities, and are recorded as both assets and liabilities in the principal amount of the acceptances and guarantees. We record the fees we earn from providing acceptances and guarantees on an accrual basis over the period of the acceptance or guarantee. As of March 31, 2006 and 2005, we had ¥813.4 billion and ¥1,058.1 billion, respectively, of outstanding acceptances and guarantees.

APLUS extends credit in the form of guarantees. The most significant component of APLUS's guarantee business is providing guarantees on installment shopping credit provided by other lenders to customers of APLUS's partner merchants. APLUS also offers collection guarantees for foreign automobile dealers. Providing guarantees allows APLUS to limit its balance sheet exposure, while continuing to maintain its relations with its partner merchants. Off-balance sheet commitment and acceptances and guarantees increased as a result of our acquisition of APLUS and its inclusion in our consolidated balance sheet from September 30, 2004. As of March 31, 2006 and 2005, ¥797.7 billion and ¥1,032.4 billion of our outstanding acceptances or guarantees, respectively, were attributable to this guarantee business.

Risk Policy and Management

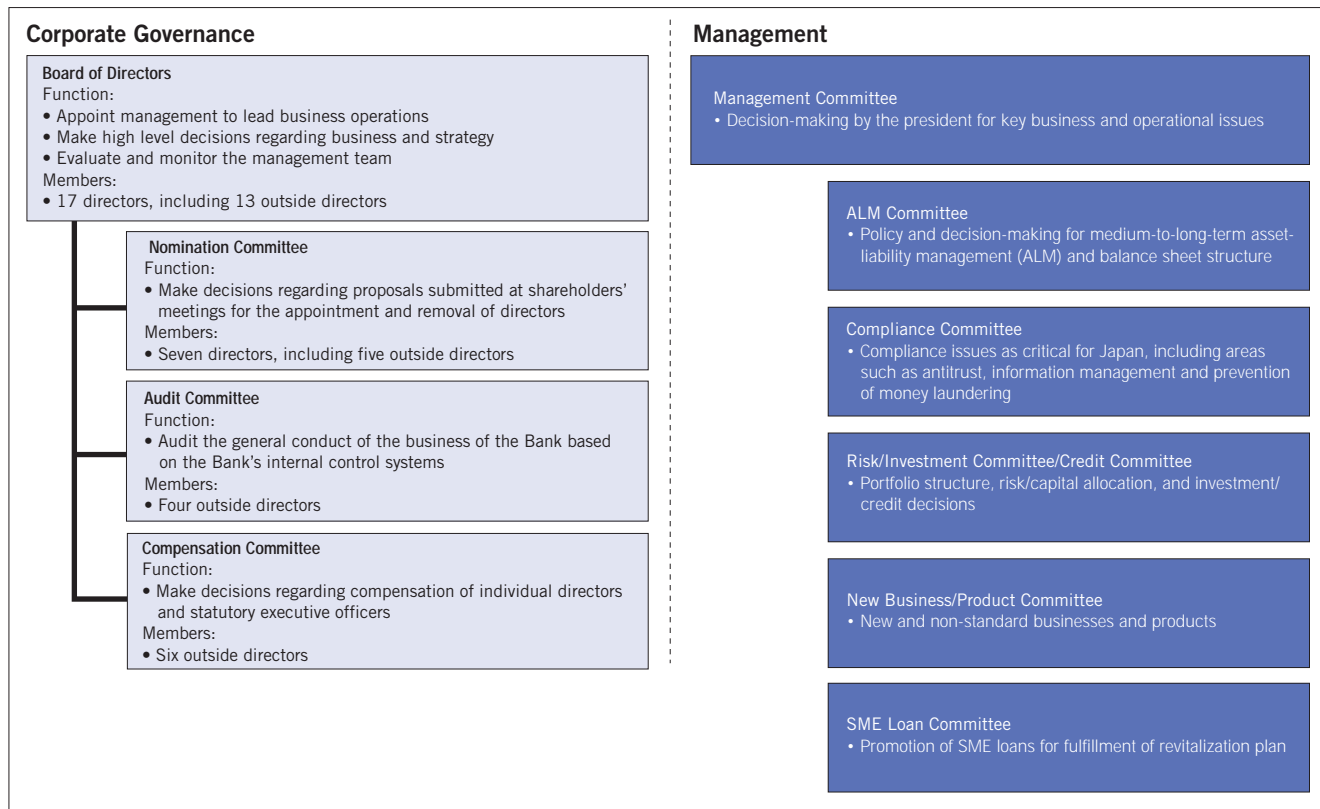
Corporate Governance and Risk Management

Overview

Our corporate governance and risk management framework enables us to manage all major aspects of our business through a coherent and well-integrated process. A detailed, sophisticated analytical structure, accompanied by diligent

surveillance and oversight, is used to evaluate and monitor risks and returns to produce sustainable revenue, reduce earnings volatility and increase shareholder value.

We have established a corporate governance and risk management structure that separates business management function. Our management structure is shown below:



Committees

We maintain several executive committees under the leadership of our Chief Executive Officer and other executive officers. The principal committees that deal with risk policy and management are listed below.

- **The ALM Committee**, as well as its subcommittee, **the Market Risk Management Committee**, reviews our balance sheet and asset/liability structure, cash liquidity and risk versus return of the trading portfolios. It also reviews and approves our analytical methodologies and parameters for liquidity and market risk analytics.
- **The Compliance Committee** reviews and resolves compliance issues relating to matters such as antitrust law, information management and prevention of money laundering.
- **The Risk/Investment Committee** establishes long-term strategy and short-term operating plans, setting overall risk appetite through capital allocation and aggregate risk levels. It also approves and reviews activities outside the normal course of our institutional and retail banking businesses. The committee reviews actual performance against plans, using established performance measures, as well as actual risk levels against forecast levels. The committee also focuses on franchise, regulatory and reputation risks.
- **The Credit Committee** aids in the establishment of and ongoing administration of corporate credit practices and policy. It approves major credit transactions for institutional customers and reviews portfolio concentrations. The committee is also responsible for reviewing the analytical methodologies and parameters for credit risk analytics.

- **The New Business/Product Committee** reviews proposals for new businesses and products through a rigorous process, in which it considers the full range of quantitative and qualitative risks, and necessary mitigating actions or controls.

While each committee has specific objectives, the common objectives, mission and mandate of all of them are to:

- delegate authority;
- clarify definitions, policies, metrics and procedures relating to, as well as methods of measuring, specific risks;
- be highly sensitive to qualitative risks, in particular regulatory and franchise risks, offering guidance to management concerning them, and establishing procedures to mitigate them; and
- ensure a decentralized internal organization and authority structure that enables the discovery, management and mitigation of risks on a day-to-day basis, in line with our strategic objectives.

Risk Management—Governing Principles

Our Risk Management Policy defines risk management as the discipline of evaluating risks, defining policies and practices that balance risk and return, and implementing the infrastructure and authority to ensure compliance with principles, policies and procedures. In this sense, “risk management” encompasses the related disciplines of compliance, audit and self-assessment/inspection.

Our Policy states three objectives:

- to establish and enhance our credit standing;
- to optimize the use of capital; and
- to create a strategic management tool.

Risk Capital Management

We use risk capital to provide a consistent, uniform and well-understood measure of risk and performance across different activities. Generally, risk capital is defined as the worst-case economic amount by which a portfolio or business may deviate from its expected financial performance as a result of unexpected, adverse events or movements in factors that affect value. Accordingly, risk capital is the excess of the economic loss in the unexpected, worst case over the estimated “average” loss. Risk capital analysis requires two parameters: time horizon and confidence level. With respect to time horizon, the time required for a change in position differs for each category of risk. The longest time horizon, or the conceptual period required to effectively alter portfolio parameters, is that of credit risk, which we estimate at one year. To enable us to compare different businesses by using one common measure, a time horizon of one year is therefore used for the entire business. Rigor-

ous analytical techniques are used to “normalize” different businesses to this time horizon. The confidence level is a management decision, based on our rating objective.

We presently calculate risk capital for the following six risk categories: (1) credit risk, (2) equities/investment risk, (3) market risk, (4) interest rate risk, (5) liquidity risk and (6) operational risk. We continually update specific analytical methodologies for each risk category.

Credit Risk Management

Credit risk is defined as the risk of loss due to a counterparty defaulting on contractual debt obligations.

Our model for credit risk management is focused on (1) securing adequate return on risk, (2) avoiding concentrations in particular sectors or to particular obligors, and (3) managing the credit portfolio with an awareness of potential losses under a worst-case scenario.

In line with this, we have established processes as follows:

- ***Credit Ratings:*** Our credit rating methodology assigns credit ratings to each obligor using neural network analytics that model the correlation between obligors’ financial data and agency ratings. Results generated by our analytics are verified by risk management. All ratings are updated on an ongoing basis with refined models and new financial data. Neural network modeling is a methodology which emulates rating agencies’ approach of labeling obligors. We have developed separate models for major industry groups. The score generated by the model is subject to adjustment by our credit rating committee when determining the rating.
- ***Default Analytics:*** Our historical default and migration data, as well as rating agency statistics, are coupled with management’s judgment to generate default probability parameters.
- ***Facility Ratings:*** Facility ratings enable comparisons of varying transactions based on expected loss by incorporating the full range of risk mitigants.
- ***Pricing Guidelines:*** Pricing thresholds are based on appropriate credit, funding and economic capital factors. These guidelines are continuously updated based on additional data and concepts.
- ***Approval Process:*** Our transaction approval process provides multiple levels of approval based on key credit sensitivities such as group exposure, group credit standing, amount, tenor and facility rating.
- ***Risk Capital:*** Our risk capital framework is a bank-wide process to measure true risk and risk/return by sector, product and transaction, thereby creating a resource monitoring and allocation tool.

Core Credit Policies

Our core credit policies make use of our experience since March 2000. These policies apply to our business with corporate, financial institution and government clients, and detail standards for the key components of the credit process: origination/approval, documentation, monitoring/management, problem recognition, remedial management and portfolio management.

Lending Guidelines

Our lending guidelines are a comprehensive set of recommended structures and disciplines that relationship managers and credit officers must follow when structuring new loan transactions.

The guidelines provide detailed recommendations on acceptable terms, interest rates, fees, amortization schedules, collateral, covenants and documentation for each class of credit risk, as well as specific procedures for communicating terms and conditions to customers. The guidelines also require a compelling explanation from Senior Credit Officers when our standard pricing or structures cannot be achieved. Relationship managers and officers are encouraged to improve our risk profile at every opportunity.

Concentration Guidelines

Our concentration management framework consists of industry concentration guidelines, obligor group concentration guidelines, as well as effective review and countermeasures for when the guidelines are exceeded. These procedures are designed to insulate our credit portfolio against systemic shock or other events outside the normal range of occurrences.

We currently use concentration guidelines to monitor two kinds of concentration:

Industry Concentration Guidelines. The purpose of industry concentration limits is to ensure management is alerted, and appropriate questions raised, when exposure to one particular industry increases rapidly. Industry concentration is managed on a risk capital basis to make the industry concentration guidelines more risk-sensitive, reflect actual portfolio conditions and account for correlation among industries.

Group Concentration Guidelines. The primary purpose of group concentration limits is to guard against "event risk," that is, to ensure that even in the case of a sudden degradation in our obligors' credit quality through rapid business deterioration, or the occurrence of a highly unexpected event, including fraud or catastrophe, our business will not be critically

impaired. Event risk is defined as any unexpected loss for reasons not realistically reflected in analyses of the historic default statistics, such as events independent of risk rating, statistical estimation error in default rates and misrated obligors.

Market Risk

Market risk, which is the risk associated with changes in the value of financial instruments from fluctuations in exchange rates, interest rates, stock prices and other market-determined price mechanisms, is inherent in all assets and liabilities, as well as off-balance sheet transactions.

Policies

We manage market risk by segregating the overall balance sheet into a trading book and a banking book. The ALM Committee, chaired by our President, is the senior review and decision-making body for the management of all market risks related to asset/liability management, and the banking and trading books. The actual risk limits for asset/liability management as well as trading, such as the value-at-risk or "VaR" method are approved by the ALM Committee. The VaR method is a procedure for estimating the probability of portfolio losses exceeding some specified proportion based on a statistical analysis of historical market price trends, correlations and volatilities.

The Market Risk Management Committee serves as an arm of the ALM Committee and is chaired by the head of Risk Management, with senior representatives from related divisions, including the Chief Financial Officer. The committee meets weekly to review detailed risk and liquidity reports from the Market Risk Management Division, which is responsible for the objective and timely recognition, monitoring and reporting of market risk in both our trading and banking operations. In addition to reporting risk information to management, administrative divisions and front office units, the Market Risk Management Division carries out regular risk analyses and recommendations.

Framework and Organization

The Treasury Division manages asset/liability risk arising from normal banking operations and the Capital Markets Division manages the active risk from trading operations in financial markets. The Treasury Division and each unit within the Capital Markets Division are assigned overall risk limits.

The Market Risk Management Division is responsible for the objective and timely recognition, monitoring and reporting of market risk in both our trading and banking operations.

In addition to reporting risk information to management, administrative divisions and front office units, it carries out regular risk analyses and recommendations. The transaction execution, operations and risk management sections operate independently, establishing a system of effective checks and balances.

Quantification of Market Risk

We have built a system capable of facilitating the recognition and management of risk by quantifying market risk frequently, tracking it objectively, and making adjustments according to market trends.

Market risk management involves the continual repetition of a five-step process. The first step is the construction of a transaction information database. The second step is data classification according to risk unit. The third step is risk quantification grouped by risk characteristics and risk unit. The fourth step is risk position summarization and report-

ing, and the fifth step is the assessment of a reported risk position and implementation of necessary adjustments. To obtain a precise picture of the current risk position, transaction data must be accurate and complete. Measurement definitions must be valid and valuation criteria such as rates and prices must be reliable. We have introduced a market risk measurement system that meets all of these requirements.

Trading Book

Methodology: We use the VaR method in our trading operations. The validity of the VaR model is verified through back testing, which examines how frequently actual daily profit or loss exceeds daily VaR for a one-day holding period. Back testing of the sample data for the fiscal year ended March 31, 2006 confirmed the continued reliability of our VaR model.

Table 37. Actual Daily VaR

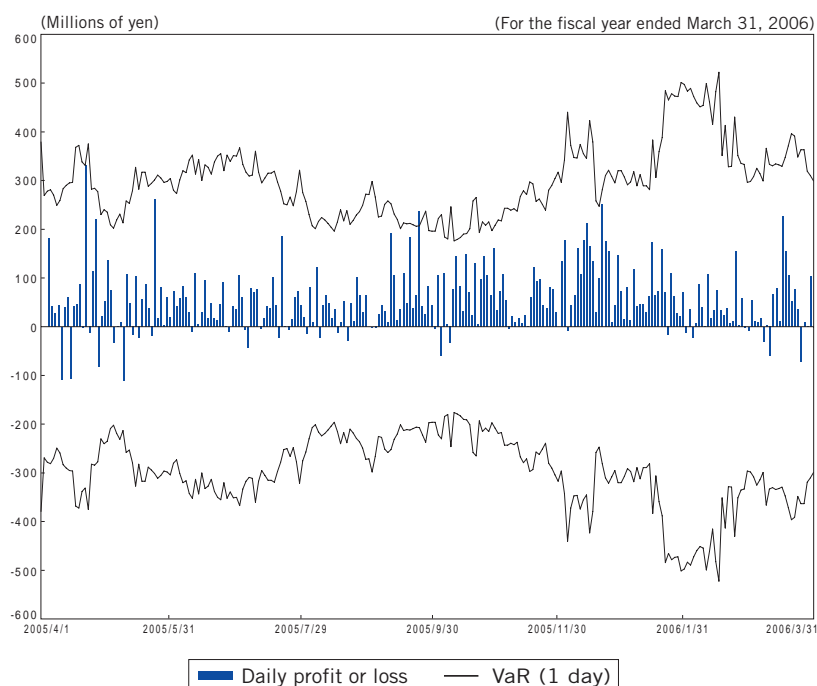
(1-day holding period, 2.33 standard deviations)

Fiscal years ended March 31	Millions of yen					
	2006			2005		
	Average	Maximum	Minimum	Average	Maximum	Minimum
	¥298	¥521	¥175	¥356	¥520	¥253

Note:

(1) Prior period has been restated to reflect consolidated basis daily VaR.

VaR and Daily Profit or Loss



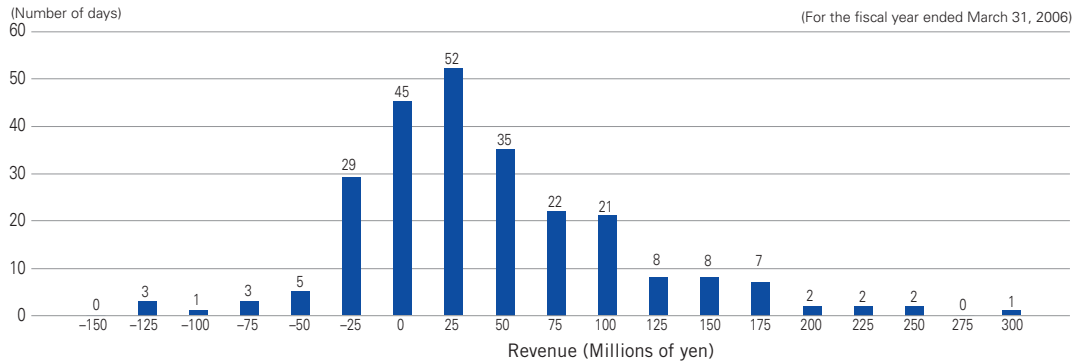
Back-Testing on the VaR Model Applied to the Trading Division's Transactions

Back-testing involves comparing the actual losses to estimated VaR to confirm the reliability of the VaR method.

Assumptions of Shinsei's VaR Model

Method: variance-covariance
 Confidence interval: 2.33 standard deviations (99% confidence interval)
 Holding period: one day
 Number of days of observations: 250
 Coverage: trading divisions
 Number of data points: approximately 850 per day

Histogram of Daily Trading-Related Revenue (Excluding Customer Margin)



Trading Activity: Our trading activity is carried out mainly on behalf of customers, although we also engage in proprietary trading activity. The allocated risk capital for proprietary trading is less than 10% of total allocated risk capital.

Limit Setting Process: Setting limits is important for appropriate risk control within Shinsei on a consolidated basis. Loss limits and VaR limits are approved by the board of directors and delegated to the Chief Financial Officer. The Chief Financial Officer sets limits for business heads, who in turn assign limits to risk takers.

Mark-Down for Trading Assets: Trading assets are normally measured by market price, yields and rates. However, the value of certain assets may also be affected by credit risk or market liquidity risk. In such cases, we use two methods to mark down the value of trading assets as necessary to reflect those risks in our financial statements.

- We record provisions for losses on derivative transactions according to obligor classifications in the same manner as on-balance transactions by taking into account current exposures as well as potential future exposures.
- We record costs for disposing of and reconstructing market-related positions centered on bid and offer costs as provisions related to market liquidity risk for derivative-related transactions in trading accounts.

Banking Book

Methodology: In our banking book, we use as principal risk indicators the bpv method and net interest income volatility. The bpv method measures the risk of changes in fair market value resulting from fluctuations in interest rates. Net interest income volatility measures the risk of changes in net interest income during a specified period, usually one year, due to fluctuations in interest rates.

Risk Limits for Banking Operations: Risk limits for banking operations are determined based on balance sheet structure and the profitability of our traditional banking activities.

New Products

We initiate new businesses, products and transactions under a disciplined and well defined launch and management process that is coordinated by the New Business/Product Committee. Members of this committee include product specialists and representatives from support areas, such as risk, compliance, accounting and operations and IT divisions. The New Business/Product Committee seeks to ensure that the product's strategy and potential are in balance; risk, legal, compliance, accounting, tax and other key considerations are addressed; and internal controls and procedures are in place to deliver the product.

The result of this effort is a formalized Product Program, which describes the policy and processes for each new product initiative. Each Product Program defines the strategic intent, investment parameters, delivery process, approval process, risk management guidelines and ongoing monitoring procedures. The Risk/Investment Committee approves the risk limits, and designates the approval authority associated with each Product Program.

Transactions within a Product Program are assessed by the product specialists and reviewed by the Risk Management Group. Through the Product Program process, the product specialists and the Risk Management Group monitor all transactions. The Risk Management Group provides monthly reporting and a more detailed quarterly update of Product Programs and transactions to the Risk/Investment Committee.

Liquidity Risk

Our ALM Committee is the senior review and decision-making body for the management of liquidity risk. The ALM Committee determines the overall limit for liquidity risk by establishing the short-term liquidity gap structure limits and minimum liquidity reserve levels. A liquidity gap structure and a minimum reserve are the principal management tools we use to monitor and manage liquidity.

Our *Liquidity Management Policy*, reviewed and approved periodically by the ALM Committee, stipulates the guidelines and norms for appropriate liquidity risk management.

To quantify liquidity risk, we have developed three liquidity forecast models:

- **Business as usual model:** This model forecasts the liquidity situation on an ongoing basis. The output of this model is an estimate of the funds we need to raise under normal circumstances.
- **Stress/event model:** This is a liquidity forecast under extraordinary circumstances. The output of this methodology is the outflow of funds under extraordinary circumstances.
- **Contractual maturity model:** This is a liquidity forecast on the assumption that assets and liabilities will be liquidated at contracted maturity, based on certain assumptions. The model indicates how much we need to raise based on our actual contractual obligations.

The output of these models is carefully analyzed and presented monthly to the ALM Committee together with a recommendation on the liquidity gap structure and minimum reserve level, as well as the underlying rationale, which is determined as follows:

- The first requirement or test is that we should be able to survive in a crisis or emergency situation; based on the assumptions relating to inflow and outflow in a stress situation, the cumulative outflow over a specified period should not exceed available reserves.
- If available reserves are insufficient to meet the test, action to remedy the situation, such as increasing reserves or changing our liability profile, must be taken.
- If available reserves are sufficient to meet the test, then reserves may be reduced, but only in a way that the first stress or emergency survival test is still met, and the liquidity gap at various times is within approved gap limits.

We also develop and maintain contingency funding plans for liquidity, including our Liquidity Crisis Contingency Plan, which clarifies specific policies and measures to deal with a liquidity crisis. We plan for the possibility that funding costs may increase, or funding may become otherwise difficult, due either to internal factors, such as a deterioration in our credit standing, or external factors such as a lack of cash liquidity in the market. These plans evaluate market-based funding capacity under various possible market conditions, and specify actions and procedures to be implemented under liquidity stress. Further, these plans address alternative sources of liquidity, measure the overall ability to fund our operations and define roles and responsibilities for

effectively managing liquidity through a period of stress, including mandating the creation of a crisis management headquarters in the event of a liquidity crisis.

Daily liquidity reports based on this model are prepared by the Risk Management Group, which also circulates the reports to business managers and senior management for review and action as necessary. More detailed reviews are conducted monthly.

Operational Risk

Operational risk refers to the risk of loss resulting from inadequate or failed internal processes or systems, human error or wrongdoing. Losses due to the fraudulent acts of employees, failed transaction processing, system failures or external fraud are typical examples.

Unlike credit risk or market risk, a risk source cannot be specified for operational risk. Frequency and severity of losses will vary greatly, ranging from operational errors that may occur frequently but have low-severity loss profiles, to frauds or serious disasters that may seldom occur but have high-severity loss profiles. There is a considerable difference between the nature of risks faced by a business line that handles simple products and operates in a systematic manner and a business line that handles complicated products and depends highly on staff with specific skills. Moreover, operational conditions, including products, sales channels and customer bases, will continue to evolve.

Monitoring Operational Risk

We have developed a risk quantification framework based on the loss-distribution method. The framework has the following three steps:

- (i) estimate the probability distribution for frequency that is applicable to historical loss records and loss scenarios,
- (ii) estimate the probability distribution for severity that is applicable to historical loss records and loss scenarios, and
- (iii) run a statistical simulation based on these two distributions to estimate an annual aggregated loss amount distribution.

Loss scenarios are established jointly by business lines and the Risk Management Group so that each business manager's perception of the relevant risk may be transformed into an appropriate source of quantitative information. This process involves all business lines, including those of our subsidiaries, and contributes to an appropriate recognition and analysis of the total risk. Senior management reviews the results of quantifying our overall operational risk capital.

Operations Risk

Operations risk is the risk of loss due to inadequate procedures or failed processing. We have established operations guidelines, reviewed and revised our organizational structure and operational procedures, and implemented training programs aimed at improving the quality of our operations. In addition, we maintain a database of operational errors that enables us to analyze the cause of operations risks in order to prevent recurrences.

Systems Risk

We have designed systems to minimize the threat of disruption, and have implemented procedures for passive recovery. Key components of our system have multiple back-ups, including at an independent back-up site in Osaka. In addition, critical data is replicated. As a result, loss of part or all of any one cluster will not disrupt system operations. In addition, comprehensive back-up procedures to support less critical systems allow restoration and recovery of these systems in the event of a malfunction. We continuously monitor system security as well as our continuity of business to maintain readiness. We introduced new systems and changes in a controlled manner and designed new systems to run in parallel with old ones, minimizing risk of incompatibility.

Our information technology infrastructure has also been certified as compliant with BS7799 and ISMS, which are international and domestic information security management system standards, by independent assessors.

Legal and Compliance Risk

Legal and compliance risk is the risk of unexpected disputes or losses due to contracts unreasonably unfavorable to us or otherwise inadvisable, or the violation of laws, regulations, orders or contracts, whether resulting in monetary damages or damages to our regulatory relationship or reputation. Our Compliance Division and Legal Division are responsible for preventing or minimizing such legal and compliance risk.

Compliance Systems Organization

The Compliance Committee, Compliance Division and individual compliance managers within various business and support units constitute the main elements of our compliance organization. The Compliance Committee, with our Chief Executive Officer as chairman, examines and discusses important matters such as the prevention of money laundering. Third-party monitoring of the Committee is carried out by outside counsel invited to serve as committee members. The Compliance Division plans various measures concerning compliance risk and promotes these measures through central management. It also assigns compliance officers

specializing in specific areas to implement compliance measures for each of our business areas. Every division, department or branch also has a compliance manager to act as the point of contact for compliance-related matters.

Compliance Activities

We produce a Compliance Program annually that outlines our compliance-related plans, including compliance promotion activities such as training programs. Programs include those concerning new laws and regulations such as the Personal Information Protection Law, as well as those on important compliance issues such as the prevention of money laundering and insider trading. Compliance materials are built directly into the training curricula for each business line.

Legal Division

The Legal Division is in charge of legal affairs, including compliance with corporate and transactional law, legal documentation and litigation supervision. The Legal Division, by providing legal analysis and advice, also supports our compliance systems.

Internal Audit

Our Internal Audit Division examines and evaluates our risk management measures and internal controls from an independent standpoint, thereby enhancing our corporate governance. The Internal Audit Division reports directly to the Chief Executive Officer and the Audit Committee of the board of directors and is independent from the operating units. This division examines and evaluates operating units' risk management, internal controls, credit quality and processes, information technology systems and processes.

Our Internal Audit Division practices a risk audit approach, in which we first assess the degree of inherent risk and adequacy of risk management and internal controls within each particular operating unit. Based on our risk assessment, we audit operating units with larger risks, new businesses, or significant changes to their organizational structure or computer systems. As part of the internal audit process, we also require operating units to perform control self-assessments and hold workshop discussions directed at addressing issues other than those relating directly to internal controls.

To strengthen our internal audit capabilities, we have continued to enhance the necessary infrastructure and developed a new audit methodology. To enhance staff expertise, we also encourage employees to obtain professional certifications such as Certified Internal Auditor and Certified Information Systems Auditor. In addition, we work with external auditors to further enhance our audit standards and capabilities.