

RISK MANAGEMENT

Fiscal Year 2007: Dislocation of Financial Markets

Fiscal year 2007 proved to be very challenging for Shinsei Bank, as well as for many other financial institutions around the world. By midsummer 2007, market liquidity had disappeared for certain asset classes, severely impacting the valuation of many of our structured instruments.

In selecting our international investment and lending activities, we have allocated Risk Capital to countries where we could partner with established local institutions and we have focused our efforts where we have a strong track record.

In fiscal year 2007, we felt the impact of the deterioration in our U.S. residential mortgage exposure, and to a lesser extent, the decline in structured credit markets worldwide. When initially making our U.S. investments, we saw the U.S. residential market as large, deep and well diversified. We directed our investments into the relatively safer end of the non-prime residential mortgage spectrum, which we felt was a more attractive opportunity than subprime. However, soon after the subprime market was brought to a virtual standstill, contagion spread to all non-prime assets. As a result of this unprecedented market dislocation, we made prudent mark-downs and reserves for our U.S. residential exposure as well as certain other structured loans and investments.

We will continue to carefully monitor markets and our exposures both in Japan and overseas, especially those most vulnerable to credit market turmoil. The Risk Management

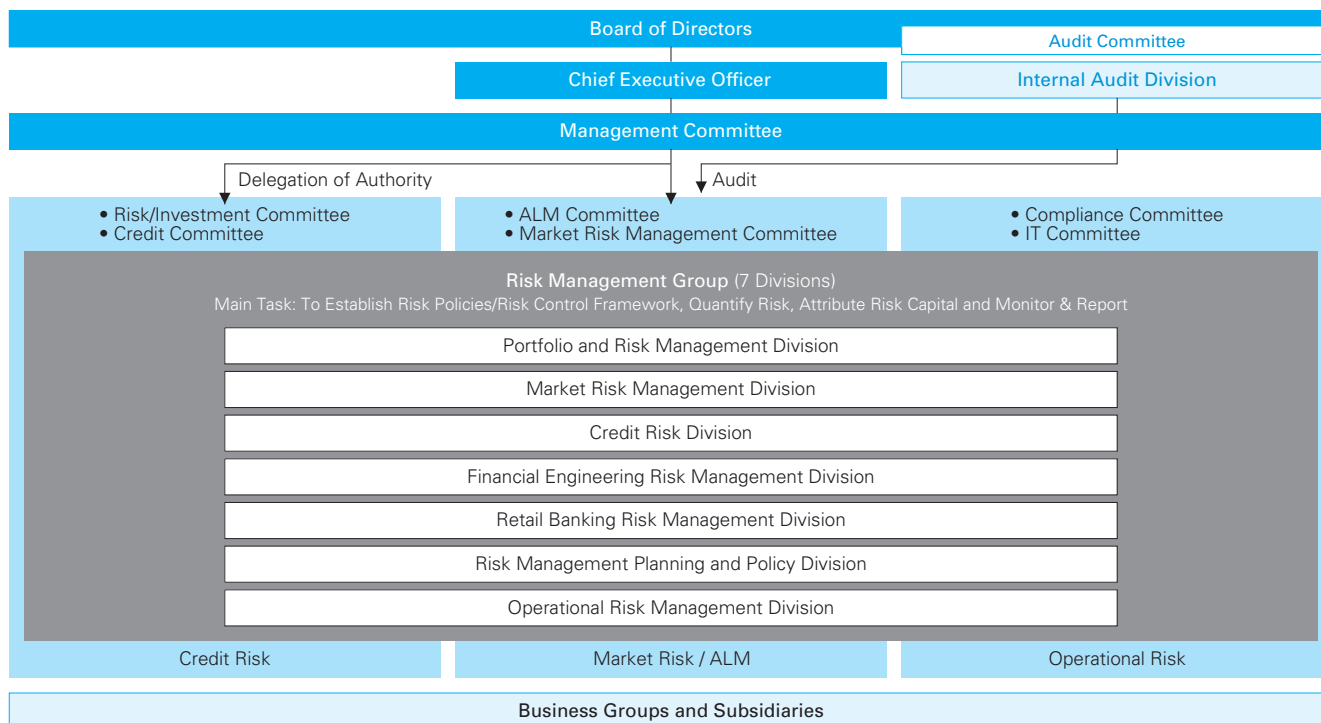
Group is working closely with our business divisions —“better together”— to proactively identify market trends, carefully manage our portfolio, tighten our investment/lending criteria, curtail certain activities and reallocate Risk Capital accordingly.

Overview

At Shinsei Bank, we emphasize that “risk is an element of our business, concerning all employees.” We endeavor to foster a risk-aware culture throughout our organization. We must take risk, and we do so in an intelligent, disciplined and collaborative manner.

The Risk Management Group works in partnership with all business units to ensure that risks are fully acknowledged and properly balanced with returns, while establishing a set of policies and guidelines. Quantitative and consistent risk analysis is regularly provided to decision makers, ensuring that they reach balanced judgments. Ongoing performance is rigorously monitored and reported to senior management so that the Bank’s activities are fully analyzed. Risk management is conducted on an integrated basis. The Risk Management Group quantifies a variety of risks throughout the organization, including credit, market and operational risk, along with relevant correlations. In addition to calculating the risk portfolio’s expected loss, we also estimate Risk Capital (also known as ‘economic capital’), which is our measurement of unexpected loss to a statistical degree

Risk Management System Chart



of confidence agreed upon in partnership with senior management. The Risk Management Group attributes Risk Capital to all transactions and activities, thereby ensuring that risk is managed consistently with other business indicators. Shinsei strives to meet the highest global standards in risk management.

Comprehensive Risk Management

Basic Concept of Risk Management Systems

In order to run highly-profitable operations, a financial institution must understand the basic challenges of risk management, namely, how to take and how to face risks.

For this reason, it is necessary to monitor whether risks are taken in line with Bank-wide policies as well as individual operational policies, whether risks remain within appropriate limits and whether they are adequately controlled by the respective sections in charge.

Financial institutions are exposed to various risks, including credit risk, market risk, liquidity risk, operational risk, systems risk, legal risk and compliance risk.

To Achieve Comprehensive Risk Management

Shinsei Bank sets forth its "Shinsei Bank Risk Management Policy" as a basic management policy in order to recognize risks and implement proactive controls based on an understanding of the total risks faced by the Bank as a whole. Under this Policy, risks are categorized as inherent within a financial institution's operations, and risk management is the basic prin-

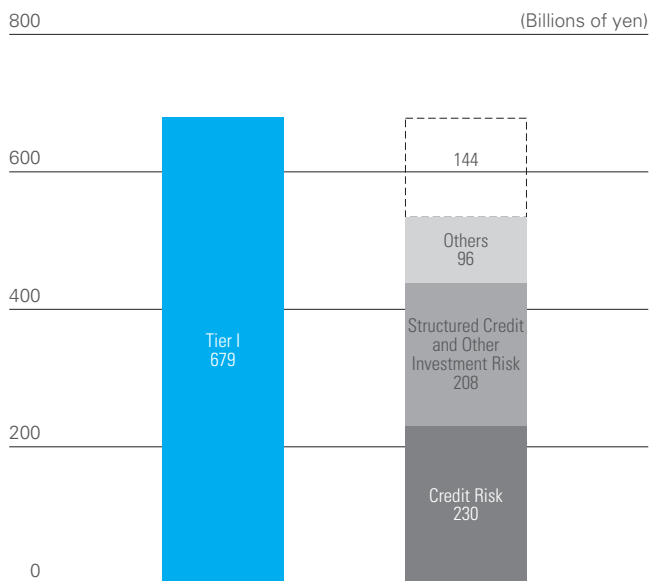
ciple for understanding the risks to which Shinsei Bank is exposed. Furthermore, risk management is the principle underlying the policies and procedures under the "Shinsei Bank Risk Management Policy," the highest-level bank rule.

Comprehensive risk management means detailed monitoring of each risk involved in individual operations, as well as the understanding of total bank-wide risks, and quantifying risks to the greatest extent possible. Estimating "Risk Capital," which is an integrated control approach, requires measurements for each risk category, namely (1) credit risk, (2) structured credit and other investment risk, (3) market risk, (4) interest rate risk, (5) liquidity risk, and (6) operational risk. In this way, our management capabilities and risk acquisition activities are controlled in an integrated manner by monitoring the Bank-wide risk volume and Group-specific capital attribution status.

As to risks inappropriate for quantification, or those that are very difficult to measure, continuous efforts are made to minimize such risks by introducing a system of checks-and-balances to enhance internal audits, and by taking necessary measures, including prevention of risk disclosures.

Shinsei Bank's senior management has delegated certain risk management authority to specific committees including the "Risk/Investment Committee," "Credit Committee," "ALM Committee" and "Market Risk Management Committee." Risk management policies are determined after thorough discussions among staff members with operational experience and expertise.

Tier I and Risk Capital by Risk Category



Assuming no correlation impact between risk categories, Risk Capital usage would be: Credit Risk 301, Structured Credit and Other Investment Risk 274 and Others 116.

Categories of Risk Capital

Risk Capital	Description
Credit Risk	Measured by subtracting expected loss from Credit Value at Risk (Credit VaR). Credit VaR is estimated maximum loss calculated by a simulation utilizing data including probability of default, exposure at default, loss given default, etc.
Structured Credit and Other Investment Risk	Measured by the most appropriate combination chosen for each investment from some methods such as default loss distribution, value range distribution, sensitivity to other factors, etc.
Market Risk	Measured by calculating estimated maximum loss from market risk based on Value at Risk method (VaR method), of which time horizon is one year.
Interest Rate Risk	Sum of Japanese yen interest rate risk measured by Value at Risk method (VaR method) and other currencies interest rate risk measured by bpv method.
Liquidity Risk	Measured by estimating liquidity gap under a stress scenario, and additional funding cost in such a case.
Operational Risk	Estimated maximum loss calculated by a simulation based on frequency and severity distributions which will be derived from actual historical loss data and scenario loss data.
Total Risk Capital	Calculated by subtracting effect of correlation across risk categories from simple sum of Risk Capital for each risk category.

Credit Risk Management

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

Our model for credit risk management focuses on securing adequate return on risk, avoiding excessive concentration in particular sectors or to particular obligors, and managing the credit portfolio with an awareness of potential losses under a worst-case scenario.

To achieve these goals, Shinsei Bank clarifies basic policies of credit operations and specific guidelines for credit risk management in the “Shinsei Bank Core Credit Policies,” “Credit Procedures” and other procedures.

Credit risk management processes are roughly classified into credit risk management for individual transactions and portfolio-based credit risk management, as follows.

Credit Risk Management for Individual Transactions

(1) ORGANIZATION/SYSTEMS

What is important in credit risk management for individual transactions is to create effective checks and balances within the flow from transaction development to credit approval to after-the-fact control operations. As a general rule, Shinsei Bank assigns approval authorities to the independent credit analysis section in the Risk Management Group. Moreover, the appropriateness of this series of credit-related operations is verified by the Internal Audit Division, which is independent from the business promotion and credit analysis sections, thereby ensuring the check-and-balance function.

Credit approval authorities are not assigned to individuals with specific posts in an exclusive manner. They are operated in a credit determination process that primarily calls for joint approvals, so as to enhance objectivity and transparency of the approval determination processes.

Shinsei Bank actively undertakes credit-related operations in new fields, such as credit trading, in order to meet diverse customer needs and to take advantage of greater profit-earning opportunities in areas where we have the necessary know-how for optimum risk management. In order to manage these products, “Product Programs” are formalized describing the procedures 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 approval authorities for each Product Program.

(2) OBLIGOR RATING SYSTEMS

Obligor rating systems, which are Shinsei Bank’s internal rating systems, are outlined as follows.

CHARACTERISTICS OF SHINSEI BANK’S OBLIGOR RATING SYSTEMS

- Increasing model accuracy and reflecting appropriate qualitative factors
- Ensuring conformity with external ratings agencies
- Properly reflecting obligors’ consolidated-basis accounting systems
- Ensuring conformity with rating systems among industry classifications

More specifically, obligor ratings are determined by applying adjustments with qualitative factors to the model ratings calculated by our estimation models, which are created using data from external rating agencies. The “Credit Rating Committee” makes the final rating determination by joint approval, ensuring transparency. Moreover, we ensure conformity of obligor ratings with obligor categories based on the regulatory self-assessment requirements.

Obligor ratings are used in the standards of credit approval authority procedures and portfolio controls, and are the foundation for credit risk management.

Furthermore, we also apply a facility rating system based on expected losses that allows for improvement in the credit status, such as through collateral and/or covenants, from the perspective of obligor ratings and comprehension of the credit status of individual transactions.

Portfolio-Based Credit Risk Management

(1) MONITORING ANALYSIS SYSTEM

Controls must be carried out in such a way that risks are diversified in terms of industries as well as ratings. This is done on a portfolio basis, which is an aggregation of transactions, and operations of individual transactions must be conducted based on appropriate risk analyses. At Shinsei Bank, the Portfolio and Risk Management Division undertakes risk analyses of portfolios, and monitors the segment-specific risk diversification status including industry classifications, ratings, specific customers/groups and also rating fluctuations related to customers within the portfolios. The Division uses this information to provide reports to senior management and the Chief Risk Officer on a monthly basis.

(2) QUANTITATIVE MEASUREMENT OF CREDIT RISK

Quantitative measurement of credit risk means quantitatively measuring and assessing the likelihood of losses that may be incurred from changes in a customer's creditworthiness. The probability of default, an assumption based on past experiences and future outlook, and expected loss amounts based on collection ratios, are generally called "expected losses."

Losses which would be incurred in the worst case scenario and which cannot be estimated based on past experiences are generally called "unexpected losses." It is generally considered that Risk Capital can be quantified by measuring "expected losses" and "unexpected losses."

Shinsei Bank ensures adequate return levels against risks involved in each transaction by measuring expected losses and unexpected losses and reflecting them in the interest rate margin on loans. Moreover, changes in Risk Capital and profitability against risks are analyzed to achieve sound portfolio operations and asset allocation.

(3) CONCENTRATION GUIDELINES

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

(4) RETAIL EXPOSURE

While we manage corporate exposures based on obligor/facility ratings, we manage retail exposures on a "pool" basis, where exposures with similar characteristics are assigned to a particular group, and risks are purposely segmented.

Credit Risks Involved in Market-Related Transactions

Credit risks involved in market transactions, such as derivative transactions, are controlled based on fair value and estimations of future value fluctuations. The volume of risks associated with market transactions changes according to fluctuations in market rates after the transaction is closed and Shinsei Bank undertakes strict controls based on future value fluctuation forecasts.

Self-Assessments

As a result of introducing the "Prompt Corrective Action" system, financial institutions conduct self-assessment of their assets, such as loans, in order to adequately write off or set aside reserves.

Shinsei Bank has established a self-assessment system wherein the Credit Assessment Division, which is independent from the business promotion and credit analysis sections, is the section ultimately responsible for assessment.

More specifically, the criteria and procedures for self-assessment adhere to the Financial Services Agency's "Inspection Manual for Deposit-Taking Institutions." Accordingly, primary assessments and final assessments are conducted by the credit analysis section and the Credit Assessment Division, respectively. For some obligors, the business promotion sections and the credit analysis section carry out the primary assessments and secondary assessments, respectively.

Obligor categories and categorizations are reviewed in a timely manner according to changes in the obligors' financial fundamentals so as to mitigate the emergence of problem loans and to strengthen and update systems to ensure the timely and accurate management of troubled loans.

Measures to Meet Basel II Requirements

In order to comply with the credit risk regulations under Basel II, which came into effect at the end of March 2007, Shinsei Bank decided to adopt the F-IRB (The Foundation Internal Ratings-Based) Approach. This framework ensures strict internal controls for our internal rating systems, the basis of credit risk management, by the execution of the design and operations of internal rating systems and parameter estimations (the probability of default). The results of the internal rating systems are reflected not only in internal controls related to credit risks, but also in calculations of capital levels required under the regulations.

Market Risk Management

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

Market Risk Management Policy

We manage market risk by segregating the overall balance sheet into a trading book and a banking book. The ALM Committee, chaired by our CEO, is the senior review and decision-making body for the management of all market risks related to asset/liability management.

The actual risk limits for asset/liability management as well as trading, such as the value-at-risk (VaR) method, are approved by the ALM Committee. The VaR method is a procedure for estimating the probability of losses exceeding a specified amount 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 the Risk Management Group with senior representatives from related divisions. The Committee meets weekly to review detailed market risk and liquidity risk 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 makes recommendations.

Trading Book

Methodology: We use the VaR method in our trading operations. Based on FSA approval, we use internal models for our General Market Risk VaR calculations for Basel II purposes. The VaR uses a 99% confidence interval, 10 day horizon period and 250 observation days. See the table below for VaR data.

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. The back-testing results for fiscal year 2007 show that there were no days in which the loss amount exceeded VaR on a consolidated basis.

Actual Daily VaR

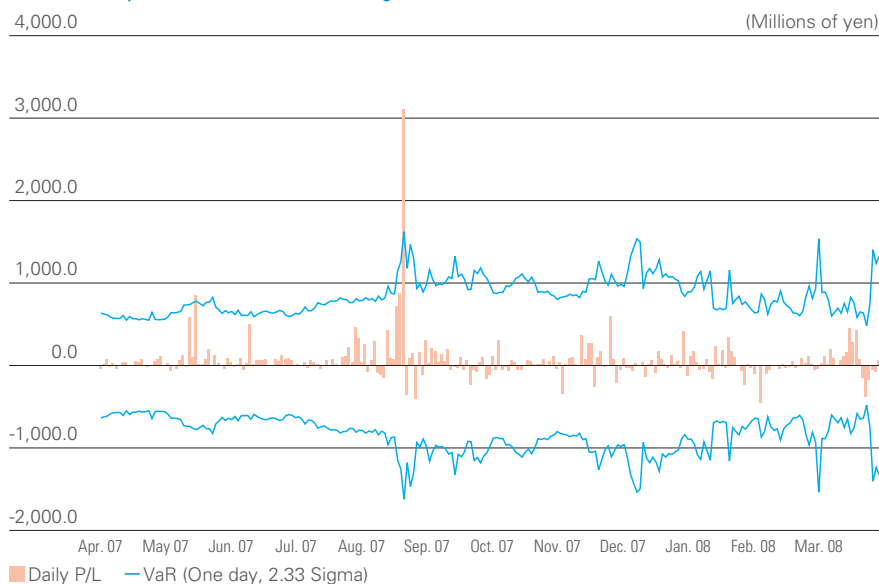
CONSOLIDATED

(ONE-DAY HOLDING PERIOD, 2.33 STANDARD DEVIATIONS)

Millions of yen

Fiscal years ended March 31	2007			2008		
	Average	Maximum	Minimum	Average	Maximum	Minimum
	526	739	287	850	1,622	480

VaR and Daily Profit or Loss (Back-Testing)



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.

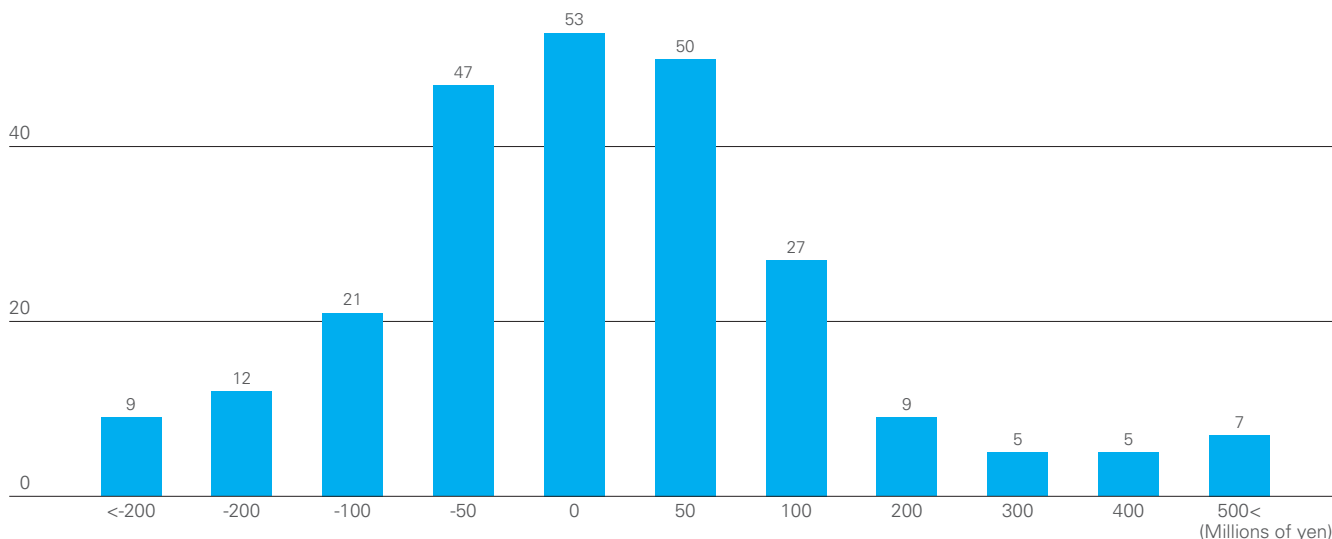
ASSUMPTIONS OF SHINSEI'S VaR MODEL

Method:	A historical simulation method except FX-related risks (variance-covariance method)
Confidence interval:	2.33 standard deviations (99% confidence interval)
Holding period:	One day
Days of observation:	250
Coverage:	Trading divisions

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

60

(Number of Days) (For the fiscal year ended March 31, 2008)



NON-CONSOLIDATED

(ONE-DAY HOLDING PERIOD, 2.33 STANDARD DEVIATIONS)

Millions of yen

Fiscal years ended March 31	2007			2008		
	Average	Maximum	Minimum	Average	Maximum	Minimum
	451	656	243	743	1,388	383

We conduct stress tests using approximately 40 scenarios. Stress tests are conducted on a weekly basis and reported to senior management at the Market Risk Management Committee meetings.

Our trading activity is carried out mainly on behalf of customers. The allocated Risk Capital for proprietary trading is less than 10% of total allocated Risk Capital.

Banking Book

Methodology: In our banking book, we use the basis point value (bpv) method and net interest income volatility as principal risk indicators. 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.

BPV METHOD

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

Impact of a 10 Basis Point Interest Rate Decline on Yen Balance Sheet Fair Market Value (Non-Consolidated)

	Billions of yen					
	Three months or less	Six months or less	Over six months to one year	Over one year to three years	Over three years	Total
On-balance sheet	-0.0	-0.0	-0.4	0.0	0.5	-0.0
Off-balance sheet	-0.0	0.0	-0.1	0.2	0.6	0.7
Total	-0.1	-0.0	-0.5	0.2	1.1	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.

Liquidity Risk

Our ALM Committee is the senior review and decision-making body for the management of liquidity risk. The ALM Committee manages liquidity risk by establishing the short-term liquidity gap structure limits and minimum liquidity reserve levels.

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. 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, 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 net cumulative outflow over a specified period should not exceed available reserves.

- If available reserves are insufficient to meet the test, then 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 minimum liquidity level reserves may be reduced, but only in such a way that the first stress test (emergency survival test) is still met and the liquidity gap at various times is within approved gap limits.

Asset Liability Management Methodology

Interest Rate Risk

We take an integrated approach to managing 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 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.

Operational Risk Management

1. Management of Operational Risk

Operational risk refers to the risk of loss resulting from inadequate or failed internal processes, people or systems or from external events. Operational risk requires organization-wide management, because it is inherent in any business activity and covers extensive risk areas.

To comprehensively manage operational risk, an Operational Risk Management Policy has been established to clarify the definitions of risk, our basic policy and system for risk management and a framework for identifying, evaluating, monitoring, reporting and controlling/mitigating risk.

The Operational Risk Management Division, which is responsible for Group-wide operational risk management, evaluates, analyzes and reports on the overall operational risks. Specific management divisions have been designated for respective risk areas comprising operational risk, such as operational and administrative risk and systems risk. They are implementing various controls, including the formulation of cross-organizational measures, standards and procedures for managing risk according to the risk characteristics of each area. The Operational Risk Management Division and specific management divisions hold monthly meetings to share information on risk management issues and measures and to discuss how to manage the common elements across the risk areas, thereby ensuring the effective management of operational risk.

Regarding measurement of operational risk, we have adopted the standardized approach for regulatory capital under Basel II. On the other hand, we have also quantified operational Risk Capital for internal use based on our internal model, by utilizing risk scenarios which reflect risk perception of business lines as well as historical losses. This quantification result has been used as part of the overall Risk Capital system.

2. Management of Operational and Administrative Risk and Systems Risk

Operational and administrative risk refers to the risk of incurring losses resulting from executives or employees' failure to perform accurate clerical work or from their errors or misconduct. Although we have expanded our Retail Banking business and developed our Institutional Banking business, we realize

that appropriately addressing such operational risk is of crucial importance in order to offer reliable services to our customers.

As measures for such risk, the Operational Planning and Administration Division, responsible for control over the overall operational errors and losses, have established various guidelines such as an "Operations Guideline" and have also implemented operational flow improvement and supervision/training to improve our operational levels. When errors do occur, we try to prevent recurrences by compiling a database of such cases and analyzing the causes. Our extensive automation/computerization and customer self-service have succeeded in minimizing the occurrence of such mistakes/errors.

We believe that the following three factors are significant for our information system strategy: security/reliability, flexibility and scalability. In particular, we have kept our information technology infrastructure robust, secure and reliable in order to ensure the security of customers' transactions. We have also established a flexible system that enables us to provide new products/services to meet customers' constantly changing needs. In addition, we have tried to ensure scalability to respond to possible increases in the number of customers and transactions in the future.

We have set up a special team tasked with minimizing systems risk. We have also improved our risk management in terms of continuity of business planning, disaster recovery planning and safeguards against personal information leakage and unauthorized access.

With regard to continuity of business planning, we have undertaken a review by conducting regular tests in light of the growing social importance of banks' online systems.

In March 2005, we extended the scope of ISMS certification, which we received in March 2004, from ITD to the entire Banking Infrastructure Group and Retail Services Sub-Group. Furthermore, we have received certification to migrate to ISO/IEC27001, which became the international and domestic information security management system standard in March 2007, and have strived to enhance our approaches to information security measures.

We provide regular status reports to management and continue to make Bank-wide efforts to manage and minimize operational and administrative risk and systems risk.