

Profile

The Bank, originally established in 1957 as The Nippon Fudosan Bank, Limited, under the Long-term Credit Bank Law, changed its name from The Nippon Credit Bank, Ltd., to Aozora Bank, Ltd., in 2001. In 2003, the Bank became majority owned by Cerberus NCB Acquisition, L.P., whereupon Hirokazu Mizukami was appointed President. In 2004, the Bank established a new organizational structure to improve the customer focus within each of the Bank's business groups and to facilitate product development and business growth.

In February 2005, Michael E. Rossi was appointed Chairman and Chief Executive Officer (CEO) to lead the Bank in developing a performance-based corporate culture, enhancing innovative business solutions and growing sustainable earnings. In June 2005, Peter C. Hagan was appointed Vice Chairman.

Aozora Bank is a leading provider of financial products and services to corporate customers, financial institutions and retail customers in Japan, providing lending, securitization, business and asset revitalization, asset management, loan syndication and investment advisory services.

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To Our Shareholders, Customers and Partners



The fiscal year ended March 31, 2005, was a significant year and an exciting time for Aozora Bank, both in terms of our financial performance and the steps we took to further improve our organization and business platform. We have been disciplined in our approach to the revitalization of the Bank all along, and as a result have created a strong, stable and competitive Aozora Bank that is focused on building a managed and sustainable competitive advantage and superior returns.

Excellent Financial Performance in the Fiscal Year Ended March 31, 2005

We achieved excellent financial results for the fiscal year ended March 31, 2005, with steady progress in key areas.

Net revenue for the period under review was up almost 11%, to ¥90.4 billion, with net income increasing to ¥86.9 billion, a 173% rise over the previous fiscal year. Business profit before general loan-loss reserve was up 17%, to ¥49.7 billion. Our activities in corporate recovery situations, investments by our special finance group, and sales of derivatives and trading activities strongly contributed to these results.

We broadened our earnings base by increasing the products and services offered to clients and the financial assets in which we invested. There was an increase of ¥262.9 billion in investments, including domestic and foreign securities, funds, investment trusts and limited partnerships. We also successfully reduced Aozora's credit exposure to specific credits and sectors to lower levels. Our loan portfolio was decreased by ¥364.4 billion as we improved the portfolio. As a result of these initiatives, the Bank enjoyed a significant rise in non-interest income, which totaled 36% of total net revenue, up from 23% in the previous fiscal year, while net interest income fell to ¥57.6 billion. We made efforts to diversify our funding sources, which yielded an increase in retail deposits, to ¥1.14 trillion.

A core element of our strategy is streamlining operations to improve cost efficiency, and in the fiscal year ended March 31, 2005, our expense ratio continued to improve, standing at 45% for the year. While General and Administrative (G&A) expenses did increase, this was a result of attracting new specialist talent to the Bank, as well as the effect of a new pro forma standard tax. G&A expenses will continue to increase as we accelerate our spending to upgrade systems and deepen the pool of experienced specialist managers.

Total regulatory capital increased 14%, to ¥617.2 billion, in the period under review. Risk-weighted assets decreased 5%, to ¥3,300.3 billion, as the Bank reduced credits considered too high or of impaired quality. The capital adequacy ratio increased to 18.70%, from 15.66% in the previous period, and the Tier I capital ratio increased to 18.31%, from 15.01%.

Customer-Focused Approach

We made considerable progress in the fiscal year ended March 31, 2005, in expanding our line of innovative financial solutions offered to our corporate and commercial customers. In securitization, for example, we undertook many challenging mandates, including the promotion of the securitization of various types of financial claims, including a new type of securitization program with a leasing company. The sophisticated management of large pools of assets is a particular skill of Aozora—one that will continue to strengthen and develop even further going forward.

From our historical roots, Aozora has long enjoyed an excellent business relationship with regional financial institutions throughout Japan, and many of these institutions have also invested in the Bank as shareholders. As these customers seek more innovative solutions to the complex issues facing them now and in the future, we are expanding our array of financing and investment products. In the fiscal year under review, we increased the volume of syndicated loan arrangements and private bond placements, and improved our sales of private placement investment funds. We have focused teams of relationship managers who can build deep, long-lasting partnerships with our financial sector clients and deliver the full potential of the Bank.

Our retail banking effort, also, made significant advances. We increased the number of customers by almost 3% year on year. Retail customers are excited by the new services and products we have introduced, from our national network of branches and improved call centers to "additional savings" products that offer clients enhanced individual returns. In the period under review, Aozora retail customers increased their call and term deposits with the Bank, while also expanding investment in savings and insurance products in which we act as intermediary.

We also announced an agreement with Yahoo Japan Corporation to develop and launch a full service internet bank. This new initiative builds on the continuing success of Netrust, Ltd, the internet payment venture which we launched in conjunction with Yahoo in 2003.

Building a Stronger Aozora Bank

We have worked hard to create a dynamic and competitive organization at Aozora. Central to these efforts is a sophisticated and thorough approach to risk management to ensure the highest levels of control. In the fiscal year ended March 31, 2005, we refined our risk assessment still further, employing new modeling techniques and systems. As a result, we can now measure credit health more precisely and understand better the impact of changing markets, currency and liquidity across the Bank as a whole. These refinements allow improved control and efficiency in the allocation of capital and provide a rational framework for pricing our growing number of products and services.

We have greatly expanded our pool of talent at Aozora, infused a more competitive spirit, and fostered a customer-focused approach to banking. Training and development have become a focus of attention, with broader knowledge allowing our bankers to deliver integrated solutions to our customers. Thanks to specialist talent, drawn from outside Aozora, the Bank now has a deeper management pool with the experience to develop and implement the products needed by our broad and diverse customer base.



Michael E. Rossi Chairman

Hirokazu Mizukami President

Peter C. Hagan Vice Chairman

We continue to strengthen our information technology (IT) platform, with a focus on implementing best-in-class solutions for our banking needs. Every office and branch is now operating on a single IT platform that allows us to monitor business and assess progress on a real-time basis.

As you read this, we will be well into the fiscal year ending March 31, 2006, which promises to be another bright year for Aozora. We accomplished a great deal in the period under review, but much still remains to be done. We thank our customers, partners, employees and stakeholders for their confidence and trust.

Yours,

July 2005

Michael E. Rossi

Chairman

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Hirokazu Mizukami

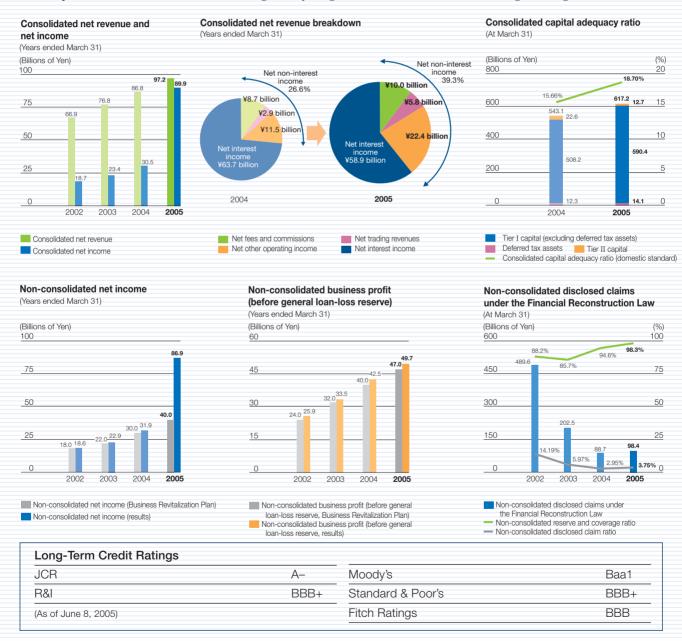
President

Potor C. Hogon

Peter C. Hagan Vice Chairman

Financial Highlights

- Thanks to a significant increase in non-interest income, we reported a 12% rise in consolidated net revenue. Net income surged 194% owing to our favorable performance, complemented by income from the reversal of reserves and other special income.
- During the period, we diversified our income sources, achieving a 66% jump in non-interest income, which reached 39.3% of consolidated net revenue.
- · We maintained a high consolidated capital adequacy ratio.
- We achieved all key financial targets (non-consolidated) under our Business Revitalization Plan for the fiscal year ended March 31, 2005.
- We kept disclosed claims within the 3.75% target set by the government. We also maintained a high coverage ratio of 98.3%.



Consolidated (Millions of Yen)

Years ended March 31	2005	2004	2003	2002
Operating income	123,679	113,788	109,748	106,700
Operating profits	45,693	7,606	8,920	14,355
Net income	89,893	30,530	23,376	18,703
Capital stock	419,781	419,781	419,781	419,781
Total stockholders' equity	611,805	526,848	497,514	477,046
Total assets	4,775,486	5,176,005	5,885,642	5,684,072
Debentures	847,993	1,054,973	1,470,126	1,468,193
Deposits (Note 1)	2,374,593	2,588,030	2,537,175	2,164,641
Loans and bills discounted	2,666,389	2,965,552	3,258,693	3,297,993
Securities	1,128,650	964,964	1,350,036	1,054,019
Total stockholders' equity per share				
(yen)	115.60	85.63	75.29	68.07
Basic net income per share (yen)	30.48	9.54	7.02	5.37
Consolidated capital adequacy ratio				
(domestic standard)	18.70%	15.66%	13.30%	14.05%
Tier I ratio (domestic standard)	18.31%	15.01%	12.51%	12.88%
Return on equity (ROE) (Note 2)	30.29%	11.86%	9.79%	8.24%

Notes: 1. Includes negotiable certificates of deposit (NCDs)

2. ROE =
(Net income – Dividends paid on preferred stock)

(Total stockholders' equity at beginning of term – Outstanding at beginning of term value) + (Total stockholders' equity at end of term value) + (Total stockholders' equity outstanding at end of term value) + 2

Non-Consolidated (Millions of Yen)

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Years ended March 31	2005	2004	2003	2002
Operating income	113,816	105,335	101,633	100,984
Business profit before general				
loan-loss reserve	49,690	42,463	33,479	25,925
Operating profits	43,733	7,309	7,437	13,706
Net income	86,859	31,854	22,875	18,563
Capital stock	419,781	419,781	419,781	419,781
Total stockholders' equity	609,524	527,582	496,918	476,166
Total assets	4,784,328	5,188,071	5,895,314	5,687,366
Debentures	851,993	1,058,973	1,473,126	1,470,193
Deposits (Note 1)	2,389,471	2,607,081	2,555,905	2,177,240
Loans and bills discounted	2,605,381	2,969,770	3,271,087	3,304,379
Securities	1,234,662	971,763	1,356,754	1,060,690
Total stockholders' equity per share				
(yen)	114.80	85.89	75.08	67.76
Net income per share (yen)	29.41	10.01	6.84	5.32
Capital adequacy ratio				
(domestic standard)	18.77%	15.65%	13.26%	14.00%
Tier I ratio (domestic standard)	18.15%	14.99%	12.47%	12.83%
Return on equity (ROE) (Note 2)	29.31%	12.44%	9.58%	8.21%

Notes: 1. Includes negotiable certificates of deposit (NCDs)

(Net income – Dividends paid on preferred stock)

2. ROE =

(Total stockholders' equity at beginning of term — Number of preferred shares outstanding at beginning of term — Variable price + (Total stockholders' equity at end of term — Variable price) + (Total stockholders' equity outstanding at end of term variable price) + 2

^{*} Yen amounts stated in millions of yen have been truncated. Amounts expressed in billions of yen have been rounded to the nearest ¥0.1 billion.



Business Operations

Aozora Bank is a strong, well-capitalized bank, with a high-quality asset base, diversified funding sources, strong liquidity and an established track record of improving revenue and earnings. The Bank is working to establish itself as the premier institution for financial management products to support Japanese corporations, financial institutions and individuals.

For Corporate Clients

For corporate clients, we provide tailored financing solutions including a broad range of advisory and support services. Through our comprehensive, customer-focused approach we have become a trusted partner for our clients.

The Bank is expanding its business and building a diversified asset portfolio through a number of carefully targeted strategies. These include developing our lending business by utilizing our network of relationships with financial institution clients, the promotion of our asset-finance business and entry into several niche markets.

Offering a Diverse Array of Funding and Investment Solutions

Building on the Bank's traditional, stable funding solutions through its corporate banking activities, such as lending for corporate investment in plant, equipment or working capital, the Bank now offers tailored solutions that draw on its extensive range of financial products. Aozora's non-traditional funding solutions include syndicated loans, private placement bonds, committed facilities and derivative-embedded loans. This broader range of more sophisticated products supports our corporate borrowers in their efforts to further diversify their funding methods. The Bank develops innovative financing products to strengthen its solutions-driven service model. Aozora is actively seeking to develop client relationships with small and medium-sized corporations that face major changes in their operating environments. We are eager to help these companies revitalize their businesses by assisting in a reappraisal of their current operations and entry into new businesses.

Loans

In our credit risk assessment process, we focus on obtaining a level of return that is appropriate for the level of risk. Our assessment methods not only carefully examine tangible asset-based collateral but also evaluate other factors such as a client's technical capabilities and the originality and competitive edge of its business model, as well as a client's ability to generate cash flow. These assessments, coupled with the use of appropriate covenants, are an integral part of our loan

operations, allowing us to work with our clients to manage and reduce risk more effectively.

Syndicated Loans

Through arranging and participating in syndicated loans for our corporate customers, we help our clients access new funding sources. We are expanding our syndicated loan services to include small- and medium-sized corporations in addition to the traditional transactions involving large corporations. In this context, the Bank has increased the number of transactions for which it has acted as lead arranger and has sought, where possible, to arrange syndicated loans in conjunction with regional financial institution partners. Syndication transactions arranged by the Bank have enjoyed strong support from a wide group of financial institutions and institutional investors.

Securitization

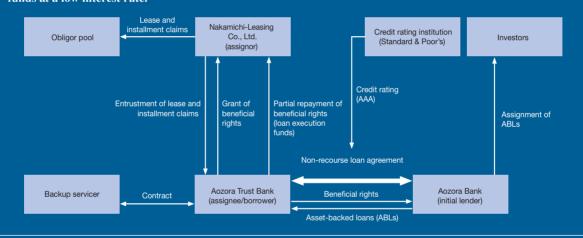
Aozora Bank assists clients with the securitization of various types of financial claims to help them achieve greater diversity in their funding sources. The Bank has experience with all types of financial claims including accounts receivable, notes receivable, leaseholds, cashing claims, credit card loans, shopping claims, automobile loans, installment receivables and medical fees, as well as other types of financial claims that have in the past been regarded as difficult to securitize. We have also focused on developing new types of securitization structures based on the most advanced methods.

New Scheme for Provision of Stable Funding at Low Interest Rates

In response to the fund-raising needs of one of Hokkaido's largest leasing firms, Nakamichi-Leasing Co., Ltd., the Bank developed a new securitization-based funding scheme.

Under the scheme, the claims to be securitized are warehoused until reaching a pre-specified amount, at which point they are securitized. After this initial securitization, further claims are warehoused up to the specified amount and then securitized. Their securitized claims are kept at the specified amount through the warehousing period and revolving period (three years). The Bank extends a loan during the six-month the warehousing period, and, after the initial securitization, the loan is backed by the asset and does not require repayment for three years. In this way, the scheme provides Nakamichi-Leasing with a stable source of funding for three-and-a-half years.

Furthermore, since the scheme has received a triple-A credit rating, the client is able to obtain the required funds at a low interest rate.



Derivatives

In April 2004, the Bank established the Derivatives Sales Division to develop and market derivative products. To meet the increasingly sophisticated and diverse needs of our clients, the Bank provides a comprehensive lineup of derivative products—including currency, interest rate and commodity swaps, as well as options.

Expanded Sales Organization

In addition to reorganizing our services—based on client characteristics such as size and type of business—we increased the number of staff at the Kansai Branch in western Japan to bolster our service capabilities in that region. We also strengthened our operations in other parts of the country

to address the significant needs that exist among small and medium-sized corporations.

Enhanced Product Development Capabilities

Our product development team—including quantitative financial experts employing the latest financial technology—works closely with our sales team to develop and provide new products designed to meet our clients' needs.

Raising Compliance Awareness: Introduction of the Qualification System for Derivatives Sales

The increasing complexity of derivative products has made it even more crucial that sales staff be able to clearly explain to clients the structure and risks associated with each product. To ensure these standards are being met and to reinforce our ability to address the complete range of client needs, we have introduced the Mandatory Certification System for our sales staff specializing in derivative products and all employees with management responsibilities in the derivatives area. This system is designed to improve individual employees' knowledge of derivative products and also enhance our sales systems and raise awareness of compliance issues throughout the Bank.

This sales system allows us to offer cost-competitive, optimal solutions to our clients based on the specific needs of each client.

Derivative Products for Corporate Clients

Client Need	Product
Foreign exchange	Currency options
risk hedging	
Interest rate and	Interest rate swaps, interest rate options,
credit risk hedging	credit default swaps, etc.
Fund-raising	MARINE BLUE (derivative-embedded loan)
Investment	MOUNTAIN BLUE (interest rate derivative-
	embedded time deposit),
	AQUA BLUE (foreign exchange derivative-
	embedded time deposit)
Other	Weather derivatives
	Commodity derivatives (oil swaps)

Other Products and Services

Private Placement Bonds

In allowing clients to tap direct financing in lower amounts and further diversify their funding sources, private placement bonds are gaining popularity in the corporate marketplace. The Bank has focused on providing services to assist clients arrange the issuance of private placement bonds, and has continued to achieve solid growth in this area.

Trustee Services

To assist our customers in accessing capital markets through bond issuance, Aozora Bank acts as trustee for private placement and public bonds, including private placement bonds of small to medium-sized corporations guaranteed by the Credit Guarantee Corporation. This trustee service has been developed through the Bank's extensive experience and expertise accumulated as an authorized issuer of and registration agency for bank debentures.

Commencement of Commodity Derivatives Operations



In June 2005, the Bank commenced commodity derivatives operations and began offering crude oil price-indexed oil swaps. Oil swaps are an effective means of hedging against the risk of higher procurement and fuel costs caused by rises in the price of crude oil. In addition to our traditional risk hedging products, including those in the area of interest rates and exchange rates, we will provide derivative products that enable clients to hedge against the risk of commodity price fluctuations, thereby bolstering our lineup of solutions to help clients manage a wide range of risks present within their balance sheets.

Supporting Business Revitalization

Aozora Bank assists corporate revitalization efforts by helping clients unlock hidden value in existing businesses and through the start of new businesses. This revitalization can be done either at the company or business unit level, and includes uncovering and evaluating under-performing businesses and dormant assets within companies.

The Bank provides leveraged finance and debtor-inpossession (DIP) finance as well as advisory services for the formulation of corporate recovery plans. The purchase of problem loans and the provision of non-recourse finance are also included within our range of services. In addition, we support business restructuring through buyout funds and provide assistance for start-up companies.

Leveraged Finance

Leveraged finance—a financing method that utilizes the cash flows projected in a company's business plan and the estimated value of the target business—plays a crucial role in business revitalization. This area includes finance for management buyouts (MBOs)—used for strategic restructuring as well as to spin off profitable divisions and subsidiaries of bankrupt companies—and finance for capital restructuring for business regeneration. Aozora Bank entered the leveraged finance field much earlier than many other domestic financial institutions, and, since then, we have firmly established a competitive market position to become one of the leading banks in this area. As demand for leveraged finance expertise grows, we will continue to respond to client needs in a swift and efficient manner.

Recovery Support

For clients facing the challenge of the rapidly changing operating environment, the Bank offers a full lineup of business recovery services. In addition to providing corporate advisory services, including the formulation of business recovery plans and assistance in finding new business sponsors, we also provide various types of lending. These include short-term working capital financing essential for

business continuity (DIP finance) and medium- and long-term lending based on a comprehensive recovery plan.

Our loan servicer subsidiary, AOZORA Loan Services Co., Ltd., provides support to financial institutions disposing of problem loans, and makes business recovery plan proposals to obligors of loans purchased by AOZORA Loan Services, thereby revitalizing the borrower's business.

Real Estate Finance

The Bank has been active in the non-recourse finance fieldalso referred to as real estate securitization—from an early stage. Under this method of financing, unlike traditional lending to corporate clients, the lender relies on cash flows generated by the subject assets—real estate. In recent years, against the background of a broad shift toward the separation of property ownership, management and operations, many companies are actively seeking ways to remove their real estate assets from their balance sheets. The reasons for this shift include preparation for new accounting standards relating to the impairment of fixed assets. In addition, since many investors now view stable, cash-generated real estate assets in a similar regard to other financial products, the nonrecourse finance market is rapidly expanding. This trend is epitomized by the introduction of Japanese real estate investment trusts (J-REITs) in September 2001, with the number and market capitalization of publicly listed J-REITs increasing year by year.

The Bank has built up a strong track record in the formulation of financing proposals and the successful execution of transactions on behalf of corporate clients. The Bank will continue to meet the diverse needs of its clients in the area of real estate ownership, management and utilization by offering a full line of sophisticated value-added services.

Private Equity

Buyout Funds

The Bank supports clients in the buyout area through the provision of merger and acquisition (M&A) advisory services and the use of buyout funds. Specifically, through the

Business Succession and Second Founding Fund, which is managed by JABOC, Ltd., and through the fund managed by Arise Capital Partners, Inc. (see page 15), the Bank is involved in providing services to various parties. These include profitable small and medium-sized corporations that are unable to find suitable successors for retiring founders, and divisions or subsidiaries of large corporations that are looking to be spun off as independent operations. The Bank has contributed to the successful completion of a number of such transactions. In the area of industry-focused buyout funds, we have jointly established IDA Capital Inc., which manages Japan's first buyout fund specializing in restructuring in the information systems industry.

Venture Capital Investment

The Bank provides value-added support and tailored lending solutions to start-up ventures. In addition, through our venture capital subsidiary, Aozora Investment Co., Ltd., we have achieved a solid track record in the incubation of new companies possessing strong technology and growth potential.

Other Financing

Ship and Aircraft Finance

The Bank provides finance for the construction and purchase of bulk carriers, chemical tankers and other ocean-going vessels, which, in recent years, have increasingly been chartered by non-Japanese shipping lines. Our ship finance group has built up considerable know-how in effectively meeting ship-financing needs. In addition, we are now engaged in aircraft financing as a new business area.

Hospital Project Finance

Aozora Bank has developed an analytical assessment method that is specifically designed for the management of medical institutions. This has been achieved through the first benchmarking survey covering major hospitals throughout Japan. Based on such skills and knowledge, we provide financial advisory services to medical institutions and offer proposals

that employ a diverse range of financing structures. Through these efforts, we have accomplished significant results in the area of hospital project finance.

For Financial Institution Clients

Aozora Bank has developed and nurtured a broad network of relationships with Japanese regional banks, and many of these financial institutions remain as shareholders of the Bank. Traditionally, these financial institutions have been strong supporters of our debenture issuance program. We are now working to provide our regional financial institution clients with a broader range of financial products and services to partner them to build and maintain strong and stable banking operations. These include products and services that may be valuable to them from a proprietary investment perspective, as well as those that can be passed on to their own client base. We aim to partner with our financial institution clients to help them address such management issues as adopting measures in compliance with the Relationship Banking Promotion Plan required under the New Action Program announced by the Financial Services Agency (FSA).

Providing a Diverse Range of Financial Products

Aozora Bank is able to meet a diverse range of needs to help clients manage their asset portfolios. In the lending field, we offer syndicated loan and derivative-embedded loans; in the area of asset management, we provide securitized financial products; and in the area of deposits, we provide derivative-embedded deposits.

Securitization

In the field of asset securitization, the Bank provides a wide variety of investment products by securitizing monetary claims such as accounts receivable, medical fees and leaseholds, and then structuring them into collateralized loan obligations (CLOs), asset-backed securities (ABS), asset-backed commercial paper (ABCP) and other instruments. We are also focusing on the securitization of such assets as housing loans and promoting our advisory services for financial institution clients in the area of securitization of clients' own assets.

Syndicated Loans

As an area of strategic focus, the Bank is arranging an increasing number of syndicated loans for corporate clients of all sizes, from large corporations to small and medium-sized corporations. For our financial institution clients, we not only provide opportunities to participate in syndicated loan deals but also jointly arrange syndicated loans for their own

corporate clients. In the future, we plan to increase our total loan volumes by diversifying syndications beyond the traditional corporate loan model to include such transactions as non-recourse loans to special purpose companies (SPCs).

Private Placement Bonds and Other Securities

As a direct financing method that has a comparatively low entry threshold, private placement bonds are gaining popularity in the corporate marketplace. The Bank has focused particularly on growing its private placement bond arrangement operations, achieving a significant increase in the total amount of bonds arranged in the fiscal year under review. In addition, as an investment product targeted at our financial institution clients, we commenced the private offering of straight corporate bonds. We have also begun private placement of such instruments as interests in limited partnerships for investment, which are de facto marketable liabilities according to revisions to the Securities and Exchange Law. We will continue our efforts to further diversify our lineup of investment products.

Privately Placed Funds

As a result of our offering a diverse selection of privately placed fund products—including intermediary sales of foreign-registered funds—we have received considerable buying interest from our financial institution clients and achieved

strong growth in the amount of funds handled. Our comprehensive product lineup consisting of an array of fund types—including long—short funds of Japanese equities, global bond funds, bank loan funds and funds of funds (from the United States, Europe and Asia)—allows our clients to obtain effective portfolio diversification. We also provide investor support through access to a wide variety of analyst reports.

Derivatives

In April 2004, the Bank established the Derivatives Sales Division to develop and market Aozora Bank's full lineup of derivative products. We endeavor to provide the highest quality service possible, based on a sound sales system and robust product lineup as well as an ongoing program of computer systems development.

Enhanced Sales Organization and Products Development Capabilities

Management has taken steps during the year to significantly improve the Bank's competitive positioning in the derivatives markets. Our product development team—including financial

engineers (quants) who employ the latest financial technology—works closely with our sales staff to develop and provide new products that meet our clients' needs. We have reorganized our sales organization and invested for future growth.

The Bank increased the number of staff at the Kansai Branch in western Japan and bolstered service capabilities to better meet our customers' needs.

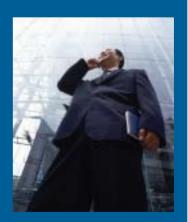
Raising Compliance Awareness: Introduction of the Qualification System for Derivatives Sales

The increasing complexity of derivative products has made it even more crucial that sales staff be able to clearly explain to clients the structure and risks associated with each product. To ensure these standards are being met as well as reinforce our ability to precisely meet a full range of client needs, we have introduced the Mandatory Certification System for our sales personnel specializing in derivatives. This system is designed to not only improve each employee's knowledge of derivative products but also raise awareness of compliance issues throughout the Bank.

Syndicated Credit Lines

The Bank recently arranged the syndication of a committed line of credit totaling ¥15.2 billion for the major real estate investment fund management company Pacific Management Corporation. In response to a request for a credit facility to be used in real estate acquisitions, the Bank proposed a scheme that included a term-out option* at the completion of a standard one-year credit line agreement, enabling the client to retain long-term ownership of any real estate acquired. Pacific Management was also looking to establish links with regional financial institutions—a need the Bank was able to meet by utilizing its network to arrange syndication of a credit line with participation from 22 institutions from all over Japan. This transaction was a good opportunity for the Bank to demonstrate its abilities in both financing scheme development and syndicate arrangement.

* Committed line of credit with a term-out option: As with a standard line of credit, a set period for the facility is agreed. Upon completion of this period, the borrower has the option to convert the credit line to a long-term loan.



This sales system allows us to offer optimal solutions to our clients based on the specific needs of each client.

Derivative Products for Financial Institution Clients

Client Need	Product
Interest rate and	Interest rate swaps, interest rate options,
credit risk hedging	credit default swaps, etc.
Investment	MOUNTAIN BLUE (interest rate derivative-
	embedded time deposit);
	Derivative-embedded loans to Aozora
	Bank: credit-linked loans, multi-callable
	loans, multi-callable reverse loans
Other	Products that are guaranteed by regional
	financial institutions: interest rate deriva-
	tives, foreign exchange derivatives; weather
	derivatives

Debentures and Deposits

To meet the needs of our financial institution clients, we offer an array of products, including bank debentures, large-lot time deposits and certificates of deposits (CDs).

Offering Solutions to Specific Management Issues

Aozora Bank helps its clients dispose of non-performing assets through the purchase of problem loans held by those financial institution clients. The Bank also provides clients with timely information and products to help them effectively develop their strategy and manage their exposure to a variety of risk types.

Helping Clients Revitalize Their Asset Base

To address clients' needs with regard to the disposal of problem loans, the Bank's subsidiary, AOZORA Loan Services, provides support for financial institution clients in the disposal of non-performing loans through the purchase of such loans. AOZORA Loan Services also provides support for regional financial institutions to help them improve the quality of their loan asset portfolios through a range of advisory services, including the formulation of business recovery plans and business strategies for their clients to which they are particularly risk-exposed.

Risk Management Services

The Bank has built an effective system for providing clients with timely information and products to help them effectively manage their exposure to a variety of risk types, and is actively developing new risk management products. As well as providing interest rate swaps and options, we are bolstering our capabilities in the provision of credit derivatives in response to growing client demand for assistance with the management of credit risk exposure.

To help clients improve their credit portfolio management, the Bank offers a wide variety of products and services. These include various means of converting loan assets to a source of liquidity, such as the purchase of sound loan assets, and providing loan participation. The Bank also provides credit derivatives.

In the area of risk management advisory services, we will continue to provide a comprehensive lineup of services based on client demand.

Internet-related Services

Since its establishment in April 2001, the Bank's subsidiary, Blue Planet Corporation, has gained a strong reputation for its Internet-based service and advisory service for management for financial institution clients and their customers.

The company will strive to further bolster its service lineup. Blue Planet's main services at present are as follows:

- Support services for building a business portal
- Support services for gaining ISO certification
- A reverse-auction electronic bidding system for buying and selling businesses
- An application service provider (ASP) solution for paperless settlements
- An outsourcing service for ATM-related operations

Making Collaborative Proposals to Clients' Corporate Customers

To meet the needs of regional financial institution clients that are required to submit a Relationship Banking Promotion Plan in accordance with the FSA's New Action Program, the Bank collaborates with such clients in assisting their corporate customers, based on its expertise in the recovery support area.

Recovery Support

For companies needing to respond to a rapidly changing operating environment, the Bank offers a full lineup of business recovery services in collaboration with its financial institution clients. In addition to providing a range of related corporate advisory services, we also provide various types of lending. These include short-term working capital financing essential for business continuity (DIP finance), and mediumand long-term lending premised on a sound recovery plan.

In the area of ship finance, the Bank provides finance for the construction and purchase of bulk carriers, chemical tankers and other ocean-going vessels. In addition, the Bank makes available its know-how—achieved through the Hospital Management Assessment Project—to the regional financial institution clients, and provides financial advisory services to their medical institution clients and offers proposals of jointly originated syndicated loan transactions.

Real Estate Finance

The Bank has been active in the non-recourse finance field—also referred to as real estate securitization—from an early

stage. In recent years, many companies are actively seeking ways to remove their real estate assets from their balance sheets, while at the same time more investors now consider real estate asset securitization as a mainstream financial product. For these reasons, the non-recourse finance market is rapidly expanding.

We collaborate with many of the industry's leading arrangers to provide primary lending and investments. We have built up a strong track record in financing proposals and successfully executed transactions for customers of our financial institution clients. The Bank will continue to meet the diverse needs of its clients in the area of real estate ownership, management and utilization by offering a lineup of value-added services.

Private Equity

As well as M&A advisory services, the Bank provides business restructuring support through funds managed by JABOC, Ltd., IDA Capital Inc., and Arise Capital Partners, Inc.

Our venture capital subsidiary, Aozora Investment Co., Ltd., is also involved in the incubation of new companies that possess strong technology and growth potential.

Establishment of Arise Capital Partners

In March 2005, Aozora Bank and the Resona Bank Group established a joint venture buyout fund management firm, Arise Capital Partners, Inc. This is the first time in Japan that two banking groups have jointly undertaken buyout fund management. In April 2005, the new company established its first fund, Arise No. 1 Investment Limited Partnership.

This joint business aims to reinforce the two banks' presence in the middle market buyout area by utilizing both banks' customer networks to develop their investment operations.



For Retail Clients

Aozora Bank has a unique and valuable group of individual customers who place a high value on products and services that help them preserve and manage their wealth. Retail banking services are accessible through our branch network covering the major population centers in Japan, as well as through telephone banking services via our call center. We will also send our staff out to meet directly with our clients at their homes or businesses to facilitate their banking with us. We have also established a tie-up with Japan Post to allow the use of Postal Savings ATMs for further convenience to our customers. To meet the diverse investment and financial planning needs of our retail clients, we offer a broad range of products including time deposits with competitive features and interest rates, investment trusts targeted at clients wishing to adopt a more active approach to investing, and variable annuity insurance products.

Asset Management Products Time Deposits

The Aozora Direct Time Deposit is provided exclusively as a telephone-banking product. Cost reductions stemming from the use of this remote channel access allow us to offer competitive interest rates, which have met with strong approval from our clients. In October 2004, we launched the Aozora Pocket Time Deposit, which permits partial withdrawals before maturity, and in June 2005, we introduced "Excellent First" time deposit, which capitalizes on advanced financial technology. By developing such products to meet our clients' needs, we will continue in our efforts to ensure greater convenience and attractive interest returns for our clients.

Investment Trusts

As of June 2005, we offered a total of 32 investment trust products to meet the diverse investment needs of our clients. These products included money management funds (MMFs), corporate and public bond investment trusts, money market funds (US\$ portfolio) and investment trusts that invest in bonds and equities in domestic and foreign markets. We also offer clients advice on investment portfolio diversification.

Personal Annuity Insurance

By offering a range of innovative products encompassing yenand foreign currency-denominated annuity products and variable annuity products, we are able to meet a diverse set of client needs, including those relating to investment, retirement income and wealth succession.

Asset Management Consulting Services Provided by Our Branch Network

Outline of Asset Management Consulting Services

In every branch, our staff provides advice to clients on their optimal investment portfolio, which may include such products as time deposits with competitive interest rates and investment trusts for more active investors. We encourage and support staff members to obtain financial planner qualifications and are committed to continually enhancing our efforts to provide the best possible advice to clients.

Our FP Promotion Department at the Bank's headquarters was established to provide a range of specialist consultation and advisory services. These services cover such areas as asset management, estate planning and business succession, with the aim of helping clients make the best choices regarding their financial needs.

Service Channels Telephone Banking Services

As well as providing exclusive access to Aozora Direct Time Deposit, our telephone banking service also lets customers purchase investment trusts and debentures as well as take care of day-to-day personal banking procedures, such as account balance inquiries and change of address notifications. Rather than simply using an automated touch tone system, our telephone banking service is staffed by a team of specialist operators—meaning even customers that are new to telephone banking will feel at ease. To further enhance the appeal of our remote banking channels, we intend to continue adding new products and services on a regular basis. In addition, we will step up our efforts to further utilize the Internet.

ATM Alliances

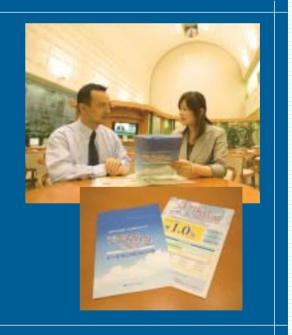
At Postal Savings ATMs located throughout Japan, Aozora Bank customers can make deposits and withdrawals seven days a week, without incurring usage fees. Used in conjunction with telephone banking services, this service ensures even greater customer satisfaction.

Aozora Financial Garden

At Aozora Financial Garden areas within our Tokyo region branches, specialist teams provide a wide variety of advisory and consultation services, such as investment, real estate asset management and home loans.

Launch of New Product "Excellent First"

In June 2005, the Bank launched a new time deposit product for retail clients, "Excellent First." This product uses the latest financial technology and responds to needs among our clients for a product with a competitive yield, guaranteed principal and coverage by the deposit insurance system. The product's unique features include early redemption at the Bank's discretion after four years of the eight-year deposit term. The product offers attractive interest yields, higher than ordinary time deposits, in return for the Bank's call option on early redemption. The Bank intends to further develop unique products catering to client needs as they arise.



Corporate Governance

Aozora Bank has developed an effective and transparent management framework underpinned by strict adherence to corporate governance principles. The management team is committed to maintaining the highest standards of legal compliance in every jurisdiction in which we operate. We continually assess potential risks, evaluating the impact and likelihood of all types of risks on our business. Our systems are designed to provide optimal transparency, maintain stringent internal controls and manage the balance of risk.

Aozora Bank's Organization: Structured for Performance

The Bank's supervision and business execution functions are separated to enable teams to focus on core strengths.

Business leaders focus on operational performance while the Bank's senior managers focus on the strategic direction of the

Bank. The Management Committee has four subcommittees to enhance operational effectiveness. Committees empowered to provide checks and balances on the management team include the Special Audit Committee and the Nomination and Remuneration Committee.



Committee Structure

Name of committee	Chaired by	Members	Frequency	Purpose
Board of Directors	Chairman, President or Vice Chairman	Directors, Corporate Auditors	Once every 3 months	Decision making regarding management strategies and supervision of operations
Board of Corporate Auditors	Corporate Auditor	Corporate Auditors	Once a month	Decision making involving audit policy and audit reports
Management Committee	Chairman, President or Vice Chairman	Chairman, President, Senior Managing Executive Officers	Once a month (Once a week)	Decision making regarding operations
Special Audit Committee	Outside Director	Corporate Auditors, Directors (except from parent companies)	As needed (Once a month)	Audit trading with parent companies in perspective of avoiding the Bank's becoming a captive bank
Nomination and Remuneration Committee	Outside Director	Outside Directors, Chairman	As needed	HR evaluation of Board members and Senior Managing Executive Officers
Asset and Liability Committee	CFO	Chairman, President, Vice Chairman, Executive Officers and General Managers in Charge	Once a month	Decision making regarding asset and liability management
Credit Committee	CCO	Chairman, President, Vice Chairman, Executive Officers and General Managers in Charge	Once a week	Approval of individual credit issues; policy decision making for settlement of individual credit issues; credit exposure solutions for large accounts; and addressing important issues concerning credit portfolio operations
Investment Committee	Vice Chairman	Chairman, President, Vice Chairman, Executive Officers and General Managers in Charge	As needed (Twice a week)	Making settlement on alternative investments
New Product/ Business Committee	Vice Chairman	CFO, CTO, CCO, CRO, Executive Officers and General Managers in Charge	Once a month	Assessment and approval of all significant new product or business

Transactions with Parent Company Groups

(Millions of Yen)

		March 31, 2005	March 31, 2004
Cerberus Group	Number of borrowers Credit balance	2 15,271	_
ORIX Group	Number of borrowers Credit balance	7 12,800	12 26,923
The Tokio Marine & Nichido Fire Insurance Group	Number of borrowers Credit balance	2 606	2 618
Total	Number of borrowers	11	14
	Credit balance	28,677	27,541

Notes: 1. Figures for credit balances refer to credit extended by Aozora Bank, its subsidiaries and affiliated companies.

- The Bank's "parent company groups" refers specifically to major shareholders and their subsidiaries and affiliated companies.
- Transactions with major shareholders and other firms include loans, customers' liabilities for acceptances and guarantees, CP, equity holdings/interest and derivative transactions.

Understanding and Managing Risk

Aozora Bank has developed a comprehensive risk management framework. All aspects of the Bank's risk management system, including the objectives, basic rules, management policies regarding credit risk, market-related risk, operational risk and other types of risk, are clearly explained in the Bank's risk management policy.

The Board of Directors develops the risk management framework for the Bank. Important decisions impacting the Bank's exposure to potential risk, including capital allocation decisions and determining risk limits for each business line, are all made by the Board of Directors.

The Board of Directors, the Management Committee and other committees receive regular risk management reports from the Internal Audit Division, as well as from each business unit and product area. The Board and Management Committee rely on these reports to oversee the Bank's overall risk position and guide management decision making.

The Bank's Risk Capital Allocation System provides comprehensive management of credit and market risks and risks related to the Bank's affiliates. Each unit is responsible for conducting operations within the risk limit provided by the Risk Capital Allocation System. The Chief Risk Officer (CRO) gathers information regarding the usage of capital by each business unit and subsequently reports the findings directly to senior management.

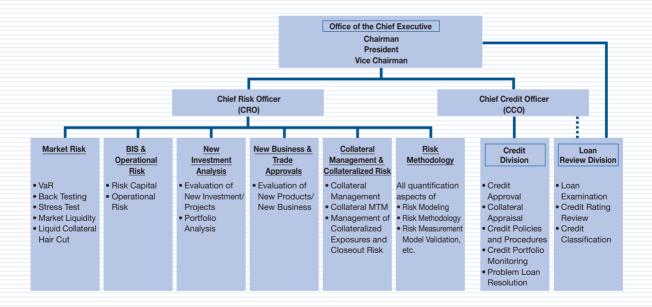
Compliance Policy

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

Master Policy on Compliance

The Bank has developed a Master Policy on Compliance, which sets forth risk for monitoring the organization, systems and basic principles, ensuring compliance with all legal regulations applying to the Bank. The Compliance Program, updated annually, specifies action guidelines and compliance standards. In the fiscal year ending March 31, 2006, the Bank plans to strengthen its training and educational programs as well as enhance the monitoring function of supervisory sections to develop an integrated compliance system.

Risk Management System



Note: The organization chart, including division names, is based on the new organizational structure of the Bank, which will be planned in September 2005.

Compliance Organization and System

Primary responsibility for supervising legal and compliance issues at the Bank rests with the Legal and Compliance Division, which develops and improves compliance systems and conducts compliance checks on relevant legal issues. An executive officer in charge of the Legal and Compliance Division is appointed Executive Compliance Officer (ECO) and the general manager of the Legal and Compliance Division supports the ECO. The division provides internal legal consulting services, including the review and authorization of contracts, and is also responsible for formulating, monitoring and revising internal regulations.

Each division and branch has a compliance leader, who is responsible for providing consultation services, carrying out compliance checks and promoting awareness of compliance-related issues.

As part of the program to build a fair and honest corporate culture, the Bank has taken two major initiatives. These are (1) the introduction of a system allowing employees to consult directly with corporate auditors and the Bank's legal advisers; and (2) the setting up of a system that enables the Legal and Compliance Division to independently communicate with employees on compliance issues. To maintain and enhance corporate identity across the entire Aozora Bank

Group, the Bank is working to develop an integrated compliance system covering all of its affiliates through such measures as the establishment of an information sharing system on compliance issues.

Compliance Training and Awareness Programs

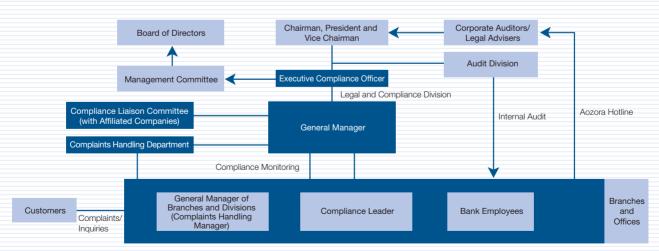
Training programs for compliance leaders and heads of division, which make use of independent experts in the field, are conducted semiannually to ensure a thorough understanding of key compliance issues. Consequently, all directors and employees throughout the Bank gain a thorough understanding of current compliance issues.

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

Anti-Money Laundering Policy

Aozora Bank has formulated Rules for the Prevention of Money Laundering, etc., which contain guidelines for carrying out proper customer identification and the reporting of suspicious transactions, so as to prevent money laundering and terrorist financing.

Compliance System



The Legal and Compliance Division supervises the Bank's anti-money laundering program. The general manager of the Legal and Compliance Division is responsible for customer identification. Each of the Bank's divisions shares a role in avoiding the risk of Bank transactions being executed for illegal activities, and disseminating information within the Bank regarding customer identification obligations.

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

New Personnel System

In April 2005, the Bank introduced a performance-based personnel system for managers. Under the new system, emphasis has been shifted away from length of service to performance and level of responsibility as the main criteria for evaluation and determination of remuneration. We believe the new system will provide a greater level of transparency and fairness.

The Bank is developing a remuneration structure that takes into account rank and level of responsibility, including a bonus system based on performance. By doing so, it aims to create a flexible evaluation and remuneration system that rewards professional excellence.

The implementation of the new personnel system has allowed the Bank to clarify roles and responsibilities for each managerial rank. This step was in line with efforts to build an organizational structure that enables the most effective management of operations in each area of our business. Furthermore, to maximize the benefits of the new personnel system, the Bank will continue to provide thorough training, assign fulfilling work to each employee and recruit experienced professionals.

The Bank also seeks to facilitate career development by enhancing various financial support programs for study and training. To help employees acquire more specialized skills and knowledge, it has established a sponsorship system for graduate-level university courses and other study programs at external institutions. The Bank has introduced a pre-entry training program for new graduate recruits and has enhanced post-entry training for these recruits so that they can soon make valuable contributions to the organization. The Bank strives to develop a broad range of skills in every individual, in addition to encouraging greater specialization by providing training suited to each employee's rank and responsibilities.

Since changing its name to Aozora Bank, Ltd., in January 2001, the Bank has recruited approximately 200 mid-career professionals. As a result, it now employs specialists that play a vital role in market-related, investment banking-related and other operations requiring a high level of expertise. The Bank has recruited 64 university graduates between April 2002—when it resumed its graduate recruitment program—and April 2005. During the recruitment of university students expecting to graduate in March 2006, each division will target candidates based on their potential to enhance the overall skill set of the organization.

The Bank will carefully evaluate the implementation of the new personnel system. At the same time, it will endeavor to offer a wider variety of improved career opportunities so that employees may develop greater skills and capabilities. Through these efforts, the Bank aims to become a more dynamic organization that enhances corporate value.

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Consolidated Business Results

Consolidated Financial Highlights [Five-Year Summary]

Years Ended March 31

(Millions of Yen)

	(IVII				
	2005	2004	2003	2002	2001
Operating income	123,679	113,788	109,748	106,700	275,730
Operating profits	45,693	7,606	8,920	14,355	99,116
Net income	89,893	30,530	23,376	18,703	98,331
Capital stock	419,781	419,781	419,781	419,781	419,781
Total stockholders' equity	611,805	526,848	497,514	477,046	460,876
Total assets	4,775,486	5,176,005	5,885,642	5,684,072	6,163,766
Debentures	847,993	1,054,973	1,470,126	1,468,193	2,479,408
Deposits	2,374,593	2,588,030	2,537,175	2,164,641	1,771,373
Loans and bills discounted	2,666,389	2,965,552	3,258,693	3,297,993	3,089,490
Securities	1,128,650	964,964	1,350,036	1,054,019	721,477
Total stockholders' equity per share					
(yen)	115.60	85.63	75.29	68.07	62.36
Basic net income per share (yen)	30.48	9.54	7.02	5.37	35.80
Diluted net income per share (yen)	21.24	7.21	5.52	4.95	29.40
Consolidated capital adequacy ratio (domestic standard) (%)	18.70	15.66	13.30	14.05	15.13
Net cash provided by (used in) operating activities	16,080	(305,027)	105,182	923,515	(1,116,186)
Net cash provided by (used in) investing activities	(164,682)	360,100	(347,870)	(376,664)	459,986
Net cash provided by (used in) financing activities	(17,610)	(7,827)	(24,261)	(20,803)	235,036
Cash and cash equivalents, end of year	171,905	338,117	290,872	557,822	31,774

Notes: 1. Up to and including the fiscal year ended March 31, 2002, total stockholders' equity per share was calculated by dividing total stockholders' equity at the fiscal year-end, less the product of the number of preferred shares issued and outstanding at the fiscal year-end and the issue price, by the number of common shares issued and outstanding at the fiscal year-end, excluding treasury stock and parent company shares held by consolidated subsidiaries.

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

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

Consolidated Financial Review

1. Consolidation and Equity-Method Companies

The consolidated financial statements as of March 31, 2005, include the accounts of the Bank and its nine consolidated subsidiaries. During the fiscal year under review, one newly established consolidated subsidiary was included and one

consolidated subsidiary was eliminated owing to the sale of its stock. No companies were accounted for using the equity method.

Consolidation and Equity-Method Companies

(Number of Companies)

March 31	2005	2004
Consolidated subsidiaries	9	9
Unconsolidated subsidiaries and affiliated companies	0	0

2. Analysis of Operating Performance

(1) Income

Total income increased ¥30.6 billion, or 22.2%, to ¥168.1 billion. Interest income declined ¥4.1 billion, to ¥76.6 billion, mainly owing to a ¥7.4 billion decrease in interest on loans and bills discounted. This latter decrease largely reflected adjustments made to the Bank's loan portfolio aimed at reducing credit risk concentration, which in turn led to the average balance of loans and bills discounted during the term, declining approximately ¥400 billion.

Fees and commissions increased ¥1.3 billion, to ¥10.9 billion. This rise was attributable to an increase in fees from such loan operations as committed lines of credit and syndicated loans, as well as higher trust income earned by a Bank subsidiary.

Trading income jumped ¥3.0 billion, to ¥5.9 billion, thanks to robust derivative operations for clients.

Other operating income rose ¥9.3 billion, to ¥26.0 billion.

Within this, gain on sales of bonds amounted to ¥5.6 billion, an increase of ¥2.7 billion from the previous term, which reflected strong gains on sales of REITs. Gains on foreign exchange transactions also increased and gains on investments in investment funds were brisk. Another contributing factor was an increase in gains on collection and sale of problem loans by a subsidiary of the Bank.

Other income climbed ¥21.1 billion, to ¥48.7 billion. Significant items within this amount included reversal of reserve for possible loan losses and reversal of reserve for credit losses on off-balance-sheet instruments, totaling ¥31.3 billion. This reflected an improvement in the quality of the Bank's loan portfolio as well as a reduction in risk relating to such operations as committed lines of credit. Also included were a ¥6.6 billion gain on the sale of stock of a subsidiary and a ¥4.5 billion gain on the transfer of the substitutional portion of employee pension fund liabilities.

(Millions of Yen)

Years Ended March 31	2005	2004	Change
Total income	168,066	137,496	30,570
Interest income	76,583	80,651	(4,068)
Interest on loans and bills discounted	54,316	61,692	(7,376)
Interest on investment securities	9,982	5,789	4,193
Interest on deposits with banks	501	390	111
Interest on other	11,782	12,778	(996)
Fees and commissions	10,878	9,593	1,285
Trading income	5,851	2,865	2,986
Other operating income	26,031	16,748	9,283
Gain on sales of bonds	5,603	2,880	2,723
Gains on foreign exchange transactions	2,832	2,347	485
Gain on derivatives		4,999	(4,999)
Other	17,595	6,522	11,073
Other income	48,721	27,637	21,084
Gain on sales of stocks and other securities	711	17	694
Reversal of reserve for possible loan losses	25,115	22,672	2,443
Reversal of reserve for credit losses on			
off-balance-sheet instruments	6,141	_	6,141
Other	16,752	4,946	11,806

(2) Expenses

Total expenses decreased ¥28.3 billion, to ¥78.0 billion. Although interest rates on domestic deposits and debentures were slightly lower, expenses relating to foreign currency fund-raising rose owing to an increase in foreign currencydenominated assets, such as foreign currency-denominated marketable securities. As a result, interest expenses increased 4.6%, or ¥0.8 billion, to ¥17.7 billion.

Other operating expenses decreased ¥1.7 billion, to ¥3.6 billion, mainly owing to a decrease in loss on sales of bonds. Tight cost-control measures enabled the Bank to restrict general and administrative expenses to a slight increase.

Other expenses fell ¥28.5 billion, to ¥9.6 billion. This decrease was partly due to a decline in credit-related expenses, such as loss on the sale of problem loans.

(Millions of Yen)

Years Ended March 31	2005	2004	Change
Total expenses	78,048	106,364	(28,316)
Interest expenses	17,692	16,914	778
Interest on debentures	4,122	5,948	(1,826)
Interest on deposits	8,165	9,092	(927)
Interest on borrowings and rediscounts	968	715	253
Interest on other	4,436	1,157	3,279
Fees and commissions	843	860	(17)
Trading expenses	47	_	47
Other operating expenses	3,599	5,286	(1,687)
Amortization of debenture issuance costs	190	225	(35)
Loss on sales of bonds	1,304	4,586	(3,282)
Loss on derivatives	208	_	208
Other	1,896	474	1,422
General and administrative expenses	46,286	45,201	1,085
Other expenses	9,579	38,101	(28,522)
Provision for reserve for credit losses on			
off-balance-sheet instruments	_	7,268	(7,268)
Write-off of claims	5,226	8,737	(3,511)
Loss on disposal of premises and equipment	62	165	(103)
Other	4,290	21,928	(17,638)

(3) Net income

As a result of the factors outlined above, income before income taxes and minority interests jumped ¥58.9 billion, to ¥90.0 billion. Net income increased ¥59.4 billion, or 194.4%, to ¥89.9 billion.

(Millions of Yen)

Years Ended March 31	2005	2004	Change	
Income before income taxes and minority interests	90,017	31,131	58,886	
Income taxes	(106)	414	(520)	
Current	706 (813)	495 (80)	211 (733)	
Minority interest in net income	231	186	45	
Net income	89,893	30,530	59,363	

3. Analysis of Financial Position

(1) Loans and bills discounted

The outstanding balance of loans and bills discounted as of the end of the fiscal year decreased by ¥299.2 billion, to ¥2.6664 trillion, reflecting decreases in the concentration of loans and reductions in loans to customers with poor credit. As a result, the Bank believes that the loan portfolio has improved and the balance sheet is strengthened.

On the other hand, risk-monitored loans on a consolidated basis in the fiscal year under review increased ¥10.6 billion, to ¥99.5 billion, due to the deteriorating situation of individual debtors. As a result, the ratio of risk-monitored loans to outstanding loans and bills discounted increased 0.7 percentage

point, to 3.7%. However, as described below, the effect that this might have on the financial position is considered to be slight due to sufficient maintenance of collateral, guarantee and provisions.

The breakdown of outstanding loans and bills discounted by type of industries and outstanding risk-monitored loans and bills discounted by type of industries is shown in the following tables. The balance of loans and bills for "Construction", "Finance & insurance", "Wholesale & retail" and "Real estate" decreased ¥192.4 billion on a YOY basis, accounting for 64% of the ¥299.2 billion reduction in total outstanding loans and bills discounted, and reflects an improvement in the portfolio.

Risk-monitored loans (consolidated)

(Millions of Yen)

March 31	2005	2004	Change	
Risk-Monitored Loan	99,535	88,930	10,605	
Loan to bankrupt companies	2,367	11,517	(9,150)	
Past due loans	88,264	66,038	22,226	
Loans overdue for 3 months or more	46	_	46	
Loans to customers under restructuring	8,857	11,374	(2,517)	
Loan balance (end of period)	2,666,389	2,965,552	(299,163)	
Ratio to loan balance	3.7	3.0	0.7	

Breakdown of outstanding loans and bills discounted by type of industries and outstanding risk-monitored loans and bills discounted by type of industries (consolidated)

(Millions of Yen)

March 31	20	2005		004
	Loans and discounts	Risk-monitored loans	Loans and discounts	Risk-monitored loans
Loans by domestic offices (excluding Japan				
Offshore Market accounts)	2,565,828	94,427	2,928,028	85,169
Manufacturing	372,547	14,949	439,428	26,644
Agriculture, forestry & fisheries	5,629	0	7,752	576
Mining	1,660	_	2,310	_
Construction	109,054	32,739	129,947	9,263
Finance & insurance	332,072	4,591	399,843	10,069
Wholesale & retail	231,461	535	302,888	8,274
Real estate	541,991	12,873	574,253	16,939
Information & communications	64,173	255	71,279	4,920
Transport	191,147	1,961	244,762	1,774
Electricity, gas, heat supply & water	18,098	43	20,701	80
Services	424,244	25,905	487,565	5,823
Local governments	8,206	_	5,550	_
Others	265,540	573	241,746	803
Loans by overseas offices and Japan offshore				
market accounts	100,561	5,107	37,523	3,761
Financial institutions	_	_	_	_
Others	100,561	5,107	37,523	3,761
Total	2,666,389	99,535	2,965,552	88,930

(2) Investment securities

As for investment securities, while investment in government bonds decreased, the Bank increased investment in funds for which higher profitability was expected, including overseas funds. As a result, investment securities increased ¥163.7 billion, to ¥1.1287 trillion. Regarding proprietary equities for limited partnership for investment business, partnerships established upon the Civil Code and silent partnerships similar to limited partnerships for investment business, the Bank and consolidated subsidiaries recorded these in investment securities from the fiscal year under review in accordance with amendments in the Securities and Exchange Act, totaling ¥51.9 billion yen.

The Bank's investment in equities only amounted to ¥1.4 billion on a consolidated basis. Therefore, volatility in stock prices is not likely to affect the Bank materially.

Outstanding balance of securities held (consolidated)

(Millions of Yen)

March 31	2005	2004
Bonds	610,216	798,334
Government bonds	538,212	728,623
Municipal bonds	5,964	4,234
Corporate bonds	66,039	65,476
Equities	1,388	1,636
Other securities	517,045	164,993
Total	1,128,650	964,964

(3) Deferred tax assets

The balance of deferred tax assets at fiscal year-end increased by ¥1.8 billion on a YOY basis, to ¥14.1 billion. Under accounting standards and with consideration to past performances and the progress made under the Business Revitalization Plan, the Bank calculates the amount of deferred tax assets based on an estimated taxable income for the subsequent fiscal year only. The proportion of deferred tax assets to equity capital was only 2.3%.

(4) Debentures and deposits

The outstanding balance of debentures and deposits at fiscal year-end is shown in the following table. The outstanding balance of debentures decreased as a result of efficient fundraising, although the Bank's debentures, centering on 2- and 5-year notes, continued to sell well. The balance of liquid deposits decreased by about ¥200.0 billion; however, the amount of total deposits declined only slightly, thanks to a steady increase in the balance of time deposits exclusive to individual telephone banking customers.

Debentures and deposits (consolidated)

(Hundred Millions of Yen)

March 31	2005	2004
Debentures	8,479	10,549
Deposits	23,745	25,880
Time deposits	19,849	19,984
Liquid deposits	3,896	5,897

Note: Deposits and time deposits include negotiable certificates of deposits.

(5) Stockholders' equity

Total stockholders' equity balance increased by ¥85.0 billion on a YOY basis, to ¥611.8 billion. There were no changes in capital stock and capital surplus. Retained earnings increased by ¥86.4 billion, to ¥156.8 billion, owing to ¥89.9 billion in net

income less ¥3.5 billion in dividends paid to the shareholders of preferred stocks. Unrealized gain on available-for-sale securities decreased by ¥1.5 billion, to ¥1.9 billion, owing mainly to lower prices on foreign currency-denominated bonds.

(6) Capital adequacy ratio (consolidated, domestic standard)

The balance of regulatory capital at fiscal year-end increased by ¥74.0 billion on a YOY basis, to ¥617.2 billion. While Tier I capital increased because of recorded net income, Tier II decreased because of repayment of subordinated debt. The balance of risk-weighted assets decreased by ¥166.8 billion

on a YOY basis, to ¥3.3003 trillion, due mainly to decreases in loans. Consequently, the consolidated capital adequacy ratio in accordance to the domestic standard improved by 3.04 percentage points on a YOY basis, to 18.70%. Tier I ratio rose by 3.30 percentage points on a YOY basis, to 18.31%.

4. Consolidated Capital Adequacy Ratio (Domestic Standard)

(Millions of Yen)

			(Millions of Yen)
March 31		2005	2004
Tier I	Capital	419,781	419,781
	Non-cumulative perpetual preferred stock	272,036	272,036
	Newly issued stock	_	_
	Capital surplus	33,333	33,333
	Retained earnings	150,609	66,724
	Minority interest in consolidated subsidiaries	802	703
	Preferred stock issued overseas	_	_
	Net unrealized losses on available-for-sale securities	_	_
	Paid-in amount on treasury stock	_	_
	Treasury stock	0	0
	Foreign currency translation adjustments	_	_
	Goodwill	_	_
	Amount equal to consolidation adjustments	_	_
	Total	604,526	520,542
	Step-up preferred stock	_	_
Tier II	Forty-five percent of the difference between fair value		
	and book value in respect of land	_	<u> </u>
	General reserve for possible loan losses	20,627	21,669
	Subordinated debt	_	1,080
	Total	20,627	22,749
	Tier II capital qualifying as capital (B)	20,627	22,749
Items deducted	(C)	7,964	146
Capital	(A) + (B) - (C) (D)	617,188	543,145
Risk-weighted assets	Balance-sheet exposure	3,058,732	3,266,608
· ·	Off-balance-sheet exposure	241,589	200,542
	Total (E)	3,300,322	3,467,150
Capital adequacy ratio	o (domestic standard) $\frac{(D)}{(E)}$ x 100	18.70%	15.66%
Tier I ratio (domestic s	tandard) (A) x 100	18.31%	15.01%

Notes: 1. The capital adequacy ratio is calculated using the formula stipulated in a Ministry of Finance Notification based on Article 14-2 of the Banking Law, which follows the provisions of Article 17 of the Long-Term Credit Bank Law. The Bank uses the domestic standard.

^{2.} Items deducted (C) is equivalent to the amount held at other financial institutions for their capital-raising purposes. This amount is not included in the consolidated financial statements.

Consolidated Financial Statements

Consolidated Balance Sheets

Aozora Bank, Ltd. and Consolidated Subsidiaries March 31, 2005 and 2004

	Millions	Thousands of U.S. Dollars (Note 1)	
ASSETS	2005	2005 2004	
Cash and cash equivalents (Note 3)	¥ 171,905	¥ 338,117	\$ 1,600,609
Deposits with banks	46,699	46,546	434,818
Call loans and bills bought	100,923	25,431	939,699
Receivables under securities borrowing transactions	195,729	211,821	1,822,431
Commercial paper and monetary claims bought	78,982	90,350	735,409
Trading assets (Notes 4, 11 and 24)	354,706	488,449	3,302,664
Money held in trust	2,385	344	22,209
Investment securities (Notes 5 and 11)	1,128,650	964,964	10,508,851
Loans and bills discounted (Notes 6 and 11)	2,666,389	2,965,552	24,826,722
Foreign exchanges (Note 7)	2,161	1,355	20,130
Other assets (Note 15)	102,531	140,538	954,665
Premises and equipment (Note 8)	28,567	29,048	265,988
Deferred charges	150	153	1,401
Deferred tax assets (Note 22)	14,147	12,323	131,723
Customers' liabilities for acceptances and			
guarantees (Note 9)	14,690	23,253	136,782
Reserve for possible loan losses (Note 10)	(133,133)	(162,247)	(1,239,609)
TOTAL	¥4,775,486	¥5,176,005	\$44,464,492

	Millions	Thousands of U.S. Dollars (Note 1)		
LIABILITIES AND STOCKHOLDERS' EQUITY	2005	2005 2004		
LIABILITIES:				
Debentures (Note 12)	¥ 847,993	¥1,054,973	\$ 7,895,653	
Deposits (Notes 11 and 13)	2,374,593	2,588,030	22,109,813	
Call money and bills sold (Note 11)	372,266	420,042	3,466,167	
Payables under repurchase agreements (Note 11)	183,824	131,598	1,711,591	
Payables under securities lending transactions				
(Note 11)	90,471	97,322	842,384	
Commercial paper		5,000		
Trading liabilities (Note 4)	88,927	88,529	828,002	
Borrowed money (Notes 11 and 14)	47,315	28,015	440,549	
Foreign exchanges (Note 7)	2	2	20	
Other liabilities (Notes 11 and 15)	125,614	184,557	1,169,592	
Liability for employees' retirement benefits (Note 16)	15,460	19,253	143,956	
Reserve for credit losses on off-balance-sheet				
instruments	1,731	7,872	16,117	
Acceptances and guarantees (Note 9)	14,690	23,253	136,782	
Total liabilities	4,162,891	4,648,453	38,760,626	
MINORITY INTERESTS	789	703	7,350	
STOCKHOLDERS' EQUITY:				
Capital stock (Note 17):				
Common stock	147,745	147,745	1,375,653	
Preferred stock	272,036	272,036	2,532,924	
Capital surplus (Note 17)	33,333	33,333	310,367	
Retained earnings (Notes 17 and 26)	156,763	70,335	1,459,624	
Unrealized gain on available-for-sale securities	1,927	3,398	17,948	
Total stockholders' equity	611,805	526,848	5,696,516	
TOTAL	¥4,775,486	¥5,176,005	\$44,464,492	
See notes to consolidated financial statements	·			

See notes to consolidated financial statements.

Consolidated Statements of Income

Aozora Bank, Ltd. and Consolidated Subsidiaries Years Ended March 31, 2005 and 2004

	Millions	Thousands of U.S. Dollars (Note 1)	
	2005	2004	2005
INCOME:			
Interest on:			
Loans and bills discounted	¥ 54,316	¥ 61,692	\$ 505,739
Investment securities	9,982	5,789	92,947
Deposits with banks	501	390	4,669
Other	11,782	12,778	109,711
Fees and commissions	10,878	9,593	101,291
Trading income	5,851	2,865	54,481
Other operating income (Note 18)	26,031	16,748	242,380
Other income (Note 19)	48,721	27,637	453,649
Total income	168,066	137,496	1,564,867
EXPENSES:			
Interest on:			
Debentures	4,122	5,948	38,382
Deposits	8,165	9,092	76,028
Borrowings and repurchase agreements	968	715	9,020
Other	4,436	1,157	41,306
Fees and commissions	843	860	7,855
Trading expenses	47		441
Other operating expenses (Note 20)	3,599	5,286	33,515
General and administrative expenses	46,286	45,201	430,968
Other expenses (Note 21)	9,579	38,101	89,197
Total expenses	78,048	106,364	726,712
INCOME BEFORE INCOME TAXES AND			
MINORITY INTERESTS	90,017	31,131	838,155
INCOME TAXES (Note 22):			
Current	706	495	6,575
Deferred	(813)	(80)	(7,571)
Total income taxes	(106)	414	(996)
MINORITY INTERESTS IN NET INCOME	231	186	2,158
NET INCOME	¥ 89,893	¥ 30,530	\$ 836,993

	Y€	U.S. Dollars	
	2005 2004		2005
PER SHARE OF COMMON STOCK (Notes 2.q and 25):			
Basic net income	¥30.48	¥9.54	\$0.28
Diluted net income	21.24	7.21	0.19
Cash dividends of the fourth preferred stock	5.00	5.00	0.04
Cash dividends of the fifth preferred stock	3.72	3.72	0.03
Cash dividends of the common stock	0.89		0.00

See notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity Aozora Bank, Ltd. and Consolidated Subsidiaries

Years Ended March 31, 2005 and 2004

	Thous	ands					
	Issued Number of Shares		Millions of Yen				
	Common Stock	Preferred Stock	Common Stock	Preferred Stock	Capital Surplus	Retained <i>F</i> Earnings	Unrealized Gain (Loss) on Available-for-sale Securities
BALANCE, APRIL 1, 2003 Net income Exclusion of consolidated subsidiaries previously included	2,834,870	914,811	¥147,745	¥272,036	¥33,333	¥ 43,293 30,530	•
in consolidated accounts						(24) (3,464)	
available-for-sale securities							2,292
BALANCE, MARCH 31, 2004	2,834,870	914,811	¥147,745	¥272,036	¥33,333	¥ 70,335 89,893 (3,464)	¥3,398
available-for-sale securities							(1,471)
BALANCE, MARCH 31, 2005	2,834,870	914,811	¥147,745	¥272,036	¥33,333	¥156,763	¥1,927

	Thousands of U.S. Dollars (Note 1)				
	Common Stock	Preferred Stock	Capital Surplus	Retained Eamings	Unrealized Gain (Loss) on Available-for-sale Securities
BALANCE, MARCH 31, 2004	\$1,375,653	\$2,532,925	\$310,367	\$ 654,891	\$31,646
Net income				836,993	3
Cash dividends on preferred stock				(32,260	0)
Net increase (decrease) in unrealized gain on					
available-for-sale securities					(13,698)
BALANCE, MARCH 31, 2005	\$1,375,653	\$2,532,925	\$310,367	\$1,459,624	\$17,948

See notes to consolidated financial statements.

Consolidated Statements of Cash Flows Aozora Bank, Ltd. and Consolidated Subsidiaries Years Ended March 31, 2005 and 2004

	Millions	Thousands of U.S. Dollars (Note 1)	
	2005	2004	2005
OPERATING ACTIVITIES:	2000	2001	2000
Income before income taxes and minority interests	¥ 90.017	¥ 31,131	\$ 838,156
Adjustments for:	1 00,017	1 01,101	Ψ 000,100
Depreciation and amortization	751	1,112	6,997
Amortization of goodwill		107	,,,,,
Net change in reserve for possible loan losses	(28,596)	(36,798)	(266,266)
Net change in liability for employees' retirement benefits	(3,792)	1,352	(35,309)
Net change in reserve for credit losses on			
off-balance-sheet instruments	(6,141)	7,268	(57,186)
Interest income	(76,583)	(80,651)	(713,067)
Interest expenses	17,692	16,914	164,736
Gain on (losses) securities sold	(7,803)	1,702	(72,660)
Gain on money held in trust	(67)	(18)	(630)
Net exchange gains (losses)	(246)	10,239	(2,293)
Net change on disposal of premises and equipment	(76)	157	(715)
Net change in trading assets	133,743	43,841	1,245,288
Net change in trading liabilities	397	(52,112)	3,701
Net change in loans and bills discounted	303,610	293,140	2,826,913
Net change in deposits	(217,475)	50,864	(2,024,914)
Net change in debentures	(206,980)	(415,153)	(1,927,188)
Net change in borrowed money (excluding subordinated)	33,300	8,500	310,056
Net change in deposits with banks	1,695	33,812	15,790
Net change in call loans and bills bought and others	(64,123)	1,234	(597,057)
Net change in receivables under securities borrowing transactions	16,092	(45,091)	149,837
Net change in call money and bills sold and others	4,450	(228,052)	41,435
Net change in commercial paper	(5,000)	2,000	(46,555)
Net change in payables under securities lending transactions	(6,850)	97,322	(63,786)
Net change in foreign exchanges (asset)	(806)	1,600	(7,505)
Net change in foreign exchanges (liability)			(5)
Interest received in cash	75,346	83,146	701,547
Interest paid in cash	(13,297)	(19,090)	(123,814)
Other—net	(22,586)	(112,933)	(210,304)
Sub-total	16,668	(304,452)	155,202
Payments of income taxes	(587)	(575)	(5,472)
Net cash provided by (used in) operating activities	16,080	(305,027)	149,730
	10,000	(000,021)	140,700
INVESTING ACTIVITIES:	(0.704.074)	/F 000 070\	(05 004 404)
Acquisition of investment securities	(3,761,274)	(5,093,878)	(35,021,181)
Proceeds from sale of investment securities	566,730	886,131	5,276,822
Redemption of investment securities	3,084,883	4,583,043	28,723,313
Increase in money held in trust	(104,098)	(59,536)	(969,261)
Decrease in money held in trust	44,892	42,681	417,990
Acquisition of premises and equipment	(1,329)	(2,319)	(12,380)
Proceeds from sale of premises and equipment	1,074	4,181	10,005
Net payment for acquisition of a subsidiary		(000)	
(affecting the scope of consolidation)	4.400	(203)	41.000
Proceeds from sale of a subsidiary	4,439		41,332
Net cash provided by (used in) investing activities	(164,682)	360,100	(1,533,360)
FINANCING ACTIVITIES:			
Repayment of subordinated debt	(14,000)	(4,095)	(130,354)
Dividends paid to preferred stock	(3,464)	(3,464)	(32,260)
Dividends paid to the minority stockholders	(145)	(243)	(1,357)
Other		(24)	,
Net cash used in financing activities	(17,610)	(7,827)	(163,971)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS		47,244	
,	(166,212)	·	(1,547,601)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	338,117	290,872	3,148,210
CASH AND CASH EQUIVALENTS, END OF YEAR (Note 3)	¥ 171,905	¥ 338,117	\$ 1,600,609

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

Aozora Bank, Ltd. and Consolidated Subsidiaries Years Ended March 31, 2005 and 2004

1. Basis of Presenting Consolidated Financial Statements

The accompanying consolidated financial statements of Aozora Bank, Ltd. (the "Bank" or the "Parent Company") and its consolidated subsidiaries have been prepared in accordance with the provisions set forth in the Japanese Securities and Exchange Law and its related accounting regulations, and in conformity with accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards.

In preparing these consolidated financial statements, certain reclassifications and rearrangements have been made to the consolidated financial statements issued domestically in order to present them in a form which is more familiar to readers outside Japan. In addition, certain reclassifications have been made in the 2004 financial statements to conform to the classifications used in 2005.

The consolidated financial statements are stated in Japanese yen, the currency of the country in which the Bank is incorporated and operates. Japanese yen figures less than a million yen are rounded down to the nearest million yen, except for per share data. As a result, the totals do not necessarily agree with the sum of the individual amounts. The translation of Japanese yen amounts into U.S. dollar amounts is included solely for the convenience of readers outside Japan and has been made at the rate of ¥107.40 to \$1, the approximate rate of exchange at March 31, 2005. Such translations should not be construed as representations that the Japanese yen amounts could be converted into U.S. dollars at that or any other rate.

2. Summary of Significant Accounting Policies

a. Consolidation—The consolidated financial statements as of March 31, 2005 include the accounts of the Bank and its consolidated subsidiaries, including Aozora Trust Bank, Ltd., Aozora Loan Services Co., Ltd., and 7 other subsidiaries in 2005 and 2004 (together, the "Group").

AZURE Funding is consolidated in the current fiscal year. Aozora Card Co., Ltd. was sold in fiscal 2004 and was eliminated from the scope of consolidation.

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

The consolidated financial statements do not include the accounts of insignificant subsidiaries such as NCM Investments Corporation, because the combined total assets, total income, net income and earned surplus would not have had a material effect on the consolidated financial statements.

Investments in the unconsolidated subsidiaries and certain affiliated companies such as Vietnam International Leasing, Co., Ltd. are stated at cost. If the equity method of accounting had been applied to the investments in these companies, the effect on the accompanying consolidated financial statements would not be material.

The difference between the cost of an acquisition and the fair value of the net assets of the acquired subsidiaries at the date of acquisition is charged to income when incurred.

All significant intercompany balances and transactions have been eliminated in consolidation. All material unrealized

profit included in assets resulting from transactions within the Group is eliminated.

- b. Cash and Cash Equivalents—Cash and Cash equivalents consist of cash on hand and due from the Bank of Japan.
- c. Trading Assets/Liabilities—Transactions for trading purposes (for the purpose of seeking to capture gains arising from short-term changes in interest rates, currency exchange rates or market prices of securities and other market-related indices or arbitrage opportunities) are included in "Trading assets" and "Trading liabilities" on a trade date basis. Trading assets and liabilities are stated at fair value.

Profits and losses on transactions for trading purposes are shown as "Trading income" and "Trading expenses" on a trade date basis.

d. Investment Securities—All investment securities are classified and accounted for, depending on management's intent, as follows: (1) trading securities which are held for the purpose of earning capital gains in the near term are stated at fair value, and the related unrealized gains and losses are included in income, (2) held-to-maturity debt securities which are expected to be held to maturity with the positive intent and ability to hold to maturity are stated at amortized cost and (3) available-for-sale securities are reported at fair value, with unrealized gains and losses, net of applicable taxes, reported in a separate component of stockholders' equity.

Non-marketable available-for-sale securities are stated at cost determined by the moving-average method. For other than temporary declines in fair value, investment securities are reduced to net realizable value by a charge to income.

As for interests in investment limited partnerships, associations under the Civil Code and silent partnerships, the Bank and its consolidated subsidiaries record net assets and net income of these partnerships as assets and profits or losses in proportion to our shares of interests based on their financial statements.

From this fiscal year, the Bank and its consolidated subsidiaries record such interests in "Investment securities", as the Securities and Exchange Law was revised to define these partnership interests as securities (per Act No. 97, June 9, 2004). These interests were recorded in "Other assets" in prior years. As a result, "Investment securities" increased by ¥51,888 million, and "Other assets" decreased by ¥51,888 million.

Securities included in money held in trust on behalf of the Bank are stated at fair value, and the related unrealized gains and losses are included in income.

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

As regards hedging interest rate risk arising from financial assets and liabilities, the Bank uses the deferral method of accounting, in accordance with "Treatment for Accounting and Auditing of Application of Accounting Standard for Financial Instruments in Banking Industry" (the Japanese Institute of Certified Public Accountants ("JICPA") Industry Audit Committee Report No. 24). In addition, "Deferred losses and gains" in the balance sheet at March 31, 2003, related to so-called "macro hedging" are being amortized as interest expense or interest income over 3 years, according to the remaining periods and notional amounts of the hedging instruments. At March 31, 2005, Deferred hedge losses related to previous "macro hedging" were ¥20,018 million and Deferred hedge gains were ¥28,428 million.

As regards hedging foreign exchange rate risk arising from financial assets and liabilities denominated in foreign currencies, the Bank also uses the deferral method of accounting, in accordance with "Treatment of Accounting and Auditing Concerning Accounting for Foreign Currency Transactions in Banking Industry" (JICPA Industry Audit Committee Report No. 25), to currency swap transactions and foreign exchange swap transactions intended to convert funding currency (JPY) to investing currencies (foreign currencies). Also, in order to hedge the foreign exchange rate risk of "Available-for-sale securities" denominated in foreign currencies, except bonds, the Bank specifies the names of securities denominated in foreign currencies fair value

hedging to the specified securities, on the condition that foreign currency denominated liabilities, including forward contracts, exceed the acquisition costs of those securities.

As regards credit derivatives, since the market for credit derivatives, including credit linked notes, was not well developed in Japan prior to April 1, 2003, credit derivatives were booked as non-mark-to-market derivatives in a manner similar to the guarantee of liabilities. However, with the expansion of the credit-derivatives market, valuation by the mark-to-market method is more readily determinable. Therefore, credit derivatives are stated at their market value.

As regards compound financial instruments whose embedded derivative transactions can be treated separately, embedded derivatives have been accounted for in conjunction with host financial assets or liabilities as a whole on an accrual basis until the previous year. From this fiscal year, as an internal management system for separate accounting was established, embedded derivatives are marked to market, separately from host financial assets or liabilities, and valuation gains or losses are recorded in profit or loss in order to present business results and financial condition more properly. As a result, Income before income taxes and minority interests for this fiscal year increased by ¥2,929 million (\$27,273 thousand).

- f. Premises and Equipment—Premises and equipment are stated at cost. Depreciation of premises and equipment of the Bank and its consolidated domestic subsidiaries is computed by the declining-balance method at rates based on the estimated useful lives of the assets, while the straight-line method is applied to buildings. The range of useful lives is principally 50 years for buildings and from 5 to 15 years for other premises and equipment.
- g. Software—Costs of software developed or obtained for internal use are depreciated over the estimated useful lives of the software (principally 5 years).
- h. Deferred Charges—Discounts on debentures are amortized by the straight-line method over the terms of the debentures. Debenture issuance expenses are amortized by the straight-line method over the shorter of the terms of the debentures or the 3-year period stipulated in Enforcement Regulations of the Japanese Commercial Code.
- i. Write-off of Loans and Reserve for Possible Loan Losses—Loans to borrowers under legal proceedings, such as bankruptcy, are written off by the amount of the loans exceed the estimated realizable value of collateral and guarantees. The amounts written off in the current fiscal year amounted to ¥9,250 million (\$86,127 thousand) and

¥8,489 million for the years ended March 31, 2005 and 2004, respectively.

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

All loans are subject to asset quality assessment conducted by the asset assessment division with the cooperation of the business-related divisions, in accordance with the Self-Assessment Standards, before the write-offs and reserves amount are finally determined.

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

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

In accordance with the enactment of the Defined Benefit Enterprise Pension Plan Law, the Bank received an approval from the Minister of Health, Labor and Welfare for the return of past retirement benefit obligations with respect to the substitutional portion of the Employees' Pension Fund of Japanese Government on January 1, 2005. The Bank derecognized the past retirement benefit obligations and related plan assets and recognized a gain of ¥4,492 million (\$41,831 thousand), recorded as Other income for the year ended March 31, 2005.

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

I. Other Reserves—Other reserves include the reserve for securities transaction liabilities. The reserve for securities transaction liabilities is required to be provided under the Securities and Exchange Law of Japan. As other reserves are immaterial amounts, they are included in Other liabilities.

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

n. Income Taxes—Deferred income taxes are recorded to reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for tax purposes. These deferred taxes are measured by applying currently enacted tax laws to the temporary differences. A valuation allowance is provided for any portion of deferred tax assets where it is considered more likely than not that it will not be realized.

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

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

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

Dividends amounting to ¥0.89 per share were proposed for stockholders of common stock for the years ended March 31, 2005.

q. Per Share Information—Basic net income per share is computed by dividing net income available to common stockholders by the weighted-average number of shares of common stock outstanding for the period, retroactively adjusted for stock splits.

Diluted net income per share reflects the potential dilution that could occur if securities were exercised or converted into common stock. Diluted net income per share of common stock assumes full conversion of the preferred stock at the beginning of the year with an applicable adjustment for related dividends to preferred stock.

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

r. New Accounting Pronouncements—In August 2002, the Business Accounting Council issued a Statement of Opinion, "Accounting for Impairment of Fixed Assets," and in October 2003 the Accounting Standards Board of Japan (ASB) issued ASB Guidance No. 6, "Guidance for Accounting Standard for Impairment of Fixed Assets." These new pronouncements are effective for fiscal years beginning on or

after April 1, 2005 with early adoption permitted for fiscal years ending on or after March 31, 2004.

The new accounting standard requires an entity to review its long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. An impairment loss would be recognized if the carrying amount of an asset or asset group exceeds the sum of the undiscounted future cash flows expected to result from the continued use and eventual disposition of the asset or asset group. The impairment loss would be measured as the amount by which the carrying amount of the asset exceeds its recoverable amount, which is the higher of the discounted cash flows from the continued use and eventual disposition of the asset or the net selling price at disposition.

The Bank expects to adopt these pronouncements as of April 1, 2005 and is currently in the process of assessing the effect of adoption of these pronouncements.

3. Cash and Cash Equivalents

Cash and cash equivalents as of March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2005	
Cash on hand	¥ 21,958	¥ 16,176	\$ 204,451
Due from the Bank of Japan	149,947	321,941	1,396,158
Total	¥171,905	¥338,117	\$1,600,609

4. Trading Assets and Liabilities

Trading assets and liabilities as of March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Trading assets:			
Trading securities	¥ 2	¥ 66,234	\$ 23
Derivatives of trading securities	7		65
Derivatives of securities held to hedge trading transactions	25	1	237
Derivatives of trading transactions	88,201	86,003	821,244
Other	266,469	336,209	2,481,095
Total	¥354,706	¥488,449	\$3,302,664
Trading liabilities:			
Trading securities sold short		¥ 6,848	
Derivatives of trading securities	¥ 4	3	\$ 41
Derivatives of securities held to hedge trading transactions	155	5	1,452
Derivatives of trading transactions	88,767	81,673	826,509
Total	¥ 88,927	¥ 88,529	\$ 828,002

5. Investment Securities

Investment securities as of March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Japanese national government bonds	¥ 538,212	¥728,623	\$ 5,011,292
Japanese local government bonds	5,964 4,234		55,535
Japanese corporate bonds	66,039 65,476		614,892
Japanese stocks	1,388 1,636		12,929
Other	517,045	164,993	4,814,203
Total	¥1,128,650	¥964,964	\$10,508,851

The carrying amounts and aggregate fair values of investment securities with readily determinable fair values as of March 31, 2005 were as follows:

	Millions of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale:				
Japanese national government bonds	¥538,144	¥ 136	¥ 98	¥538,182
Japanese local government bonds	5,401	89	2	5,488
Japanese corporate bonds	12,808	176	5	12,979
Other*	280,514	5,478	2,524	283,468
Held-to-maturity				
Japanese national government bonds	29			30
Total	¥836,899	¥5,881	¥2,630	¥840,150

	Thousands of U.S. Dollars			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale:				
Japanese national government bonds	\$5,010,657	\$ 1,270	\$ 914	\$5,011,014
Japanese local government bonds	50,296	831	22	51,105
Japanese corporate bonds	119,260	1,646	53	120,853
Other*	2,611,870	51,009	23,506	2,639,372
Held-to-maturity				
Japanese national government bonds	279	3		282
Total	\$7,792,362	\$54,759	\$24,495	\$7,822,626

The carrying amounts and aggregate fair values of investment securities with readily determinable fair values as of March 31, 2004 were as follows:

	Millions of Yen			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Available-for-sale:				
Japanese national government bonds	¥728,860	¥ 42	¥290	¥728,612
Japanese local government bonds	3,700	58	34	3,724
Japanese corporate bonds	30,337	622	80	30,879
Japanese stocks	3	31		35
Other*	51,296	5,501	120	56,676
Held-to-maturity				
Japanese national government bonds	10			10
Total	¥814,208	¥6,257	¥526	¥819,939

^{*} Other includes investments in partnership and others which were reported at fair value.

Available-for-sale securities whose fair value was not readily determinable as of March 31, 2005 and 2004, were as follows:

	Carrying Amount			
	Millions	Thousands of U.S. Dollars		
	2005	2004	2005	
Available-for-sale:				
Japanese local government bonds	¥ 475	¥ 509	\$ 4,430	
Japanese corporate bonds	53,059	34,596	494,039	
Japanese stocks	1,330	1,559	12,391	
Claims on loan trust	9,200	6,793	85,670	
Investment in partnership	44,065		410,297	
Other	122,576	108,503	1,141,304	
Total	¥230,709	¥151,963	\$2,148,131	

Proceeds from sales of available-for-sale securities and the gross realized gains and losses on these sales for the years ended March 31, 2005 and 2004, were as follows:

	Carrying Amount			
	Millions	Thousands of U.S. Dollars		
	2005	2005		
Proceeds from sales	¥569,325	¥887,557	\$5,300,986	
Gross realized gains	6,314	2,897	58,798	
Gross realized losses	1,304	4,589	12,144	

The carrying values of debt securities by contractual maturities for securities classified as available-for-sale and held-to-maturity as of March 31, 2005, were as follows:

	Millions of Yen		Thousands of U.S. Dollars	
March 31, 2005	Available for Sale	Held to Maturity	Available for Sale	Held to Maturity
Due in one year or less	¥430,264		\$4,006,185	
Due after one year through five years	218,767	¥29	2,036,940	\$279
Due after five years through ten years	51,510		479,613	
Due after ten years	226,027		2,104,541	
Total	¥926,569	¥29	\$8,627,279	\$279

The carrying values and valuation gain recognized in the consolidated statements of income for trading securities as of March 31, 2005 and 2004, were as follows:

	Millions	Thousands of U.S. Dollars	
	2005	2005	
Trading securities:			
Carrying value	¥328,109	¥402,444	\$3,055,028
Valuation gain (loss) included in income (loss)			
before income taxes	3,429	(500)	31,932

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

6. Loans and Bills Discounted

Loans and bills discounted as of March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Bills discounted	¥ 6,181	¥ 6,310	\$ 57,555
Loans on notes	291,925	416,967	2,718,112
Loans on deeds	2,176,465	2,359,561	20,265,046
Overdrafts	191,817	182,713	1,786,009
Total	¥2,666,389	¥2,965,552	\$24,826,722

"Loans to bankrupt borrowers" are loans to borrowers who are legally bankrupt and amounted to ¥2,367 million (\$22,040 thousand) and ¥11,517 million as of March 31, 2005 and 2004, respectively. "Past due loans" are nonaccrual loans except for loans to bankrupt borrowers and loans to borrowers for which concessions on payments of interests were made in order to assist the reorganization of borrowers and amounted to ¥88,264 million (\$821,826 thousand) and ¥66,038 million as of March 31, 2005 and 2004, respectively.

"Loans over due for three months or more" are those loans for which principal or interest remains unpaid for at least three months, excluding loans to bankrupt companies and past due loans and amounted to ¥46 million (\$435 thousand) and nil as of March 31, 2005 and 2004, respectively.

"Restructured loans" are loans, excluding loans to bankrupt borrowers, past due and/or overdue for three months or more, for which concessions are made in the borrower's favor on interest or principal payment or to waive claims for the purpose of assisting in the reconstruction of insolvent borrowers and amounted to ¥8,857 million (\$82,469 thousand) and ¥11,374 million as of March 31, 2005 and 2004, respectively.

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

Overdraft contracts and contracts for loan commitments are those by which consolidated subsidiaries are bound to extend loans up to a prearranged amount, at the request of customers, unless the customer is in breach of contract conditions. The unutilized balance of these contracts amounted to ¥362,407 million (\$3,374,368 thousand) and ¥349,720 million as of March 31, 2005 and 2004, respectively. ¥272,305 million (\$2,535,437 thousand) and ¥300,891 million of these amounts relate to contracts with original contractual terms of one year or less as of March 31, 2005 and 2004, respectively.

The amount of loans sold through senior certificates under a collateralized loan obligation (CLO) securitization totaled ¥100,000 million (\$931,099 thousand) and ¥100,000 million for the years ended March 31,2005 and 2004, respectively, with the subordinated certificates retained by the Bank totaling ¥34,603 million (\$322,195 thousand) and ¥34,400 million as of March 31, 2005 and 2004, respectively, recorded as loans

7. Foreign Exchanges

Foreign exchanges as of March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Assets:			
Due from foreign banks	¥2,161	¥1,355	\$20,130
Total	¥2,161	¥1,355	\$20,130
Liabilities:			
Due to foreign banks	¥ 2	¥ 2	\$ 20
Total	¥ 2	¥ 2	\$ 20

8. Premises and Equipment

Accumulated depreciation amounted to ¥22,183 million (\$206,548 thousand) and ¥22,370 million as of March 31, 2005 and 2004, respectively.

9. Customers' Liabilities for Acceptances and Guarantees

All contingent liabilities arising from acceptances and guarantees are reflected in acceptances and guarantees. As a contra account, customers' liabilities for acceptances and

guarantees are shown as assets representing the Bank's right of indemnity from customers.

10. Reserve for Possible Loan Losses

A reserve for possible loan losses as of March 31, 2005 and 2004, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
General reserve	¥ 95,927	¥127,623	\$ 893,178
Specific reserve	36,523	33,960	340,070
Reserve for loans to restructuring countries	683	663	6,361
Total	¥133,133	¥162,247	\$1,239,609

11. Collateral

The carrying amounts of assets pledged as collateral and the collateralized debt as of March 31, 2005 and 2004, were as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Assets:			
Investment securities	¥277,055	¥290,970	\$ 2,579,661
Loans and bills discounted	382,340	334,885	3,559,964
Trading assets	133,605	207,644	1,244,003
Total	¥793,001	¥833,501	\$7,383,628
Debts:			
Deposits	¥ 30,000	¥ 30,000	\$ 279,330
Borrowed money	100	100	931
Call money and bills sold	153,400	228,500	1,428,306
Payables under repurchase agreements	183,824	131,598	1,711,591
Payables under securities lending transactions	72,756	65,006	677,433
Total	¥440,081	¥455,204	\$4,097,591

In addition, the following assets were pledged or deposited as margin money with respect to foreign exchange settlements and derivatives as of March 31, 2005 and 2004:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Investment securities	¥127,940	¥128,333	\$1,191,254
Total	¥127,940	¥128,333	\$1,191,254

12. Debentures

Debentures as of March 31, 2005 and 2004, consisted of the following:

March 31, 2005	Millions of Yen	Thousands of U.S. Dollars	Interest Rates
One-year discount debentures	¥ 40,861	\$ 380,461	0.03%-0.06%
One-year coupon debentures	26,900	250,465	0.10%-0.20%
Two-year coupon debentures	465,700	4,336,127	0.15%-1.10%
Three-year coupon debentures	39,850	371,043	0.20%-1.20%
Five-year coupon debentures	274,681	2,557,557	0.10%-1.80%
Total	¥847,993	\$7,895,653	

March 31, 2004	Millions of Yen	/	Interest Rates
One-year discount debentures	¥ 51,241		0.04%-0.08%
One-year coupon debentures	261,550		0.10%-0.90%
Two-year coupon debentures	410,300		0.15%-1.10%
Three-year coupon debentures	100,650		0.20%-1.25%
Five-year coupon debentures	231,231		0.10%-2.50%
Total	¥1,054,973		

13. Deposits

Deposits as of March 31, 2005 and 2004, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Current deposits	¥ 44,002	¥ 108,014	\$ 409,705
Ordinary deposits	297,588	434,930	2,770,847
Deposits at notice	13,088	23,401	121,870
Time deposits	1,469,497	1,450,231	13,682,469
Negotiable certificates of deposit	515,480	548,120	4,799,628
Other	34,936	23,332	325,294
Total	¥2,374,593	¥2,588,030	\$22,109,813

14. Borrowed Money

The weighted averaged annual interest rates applicable to borrowed money were 1.12% and 2.14% as of March 31, 2005 and 2004, respectively.

Borrowed money includes subordinated borrowings, which were ¥5,400 million (\$50,279 thousand) and ¥19,400 million as of March 31, 2005 and 2004, respectively.

Annual maturities of borrowed money as of March 31, 2005, for the next five years and thereafter were as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2006	¥ 5,400	\$ 50,279
2007	500	4,655
2008	1,100	10,242
2009	1,015	9,451
2010	11,000	102,421
2011 and thereafter	28,300	263,501
Total	¥47,315	\$440,549

15. Other Assets and Liabilities

Other assets and liabilities as of March 31, 2005 and 2004, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Other assets:			
Accrued income	¥ 5,634	¥ 4,775	\$ 52,465
Investments in partnership	4,751	39,245	44,241
Derivative financial instruments	40,330	35,467	375,514
Financial stabilization fund	32,628	32,628	303,799
Other	19,186	28,421	178,646
Total	¥102,531	¥140,538	\$ 954,665
Other liabilities:			
Accrued expenses	¥ 15,636	¥ 11,018	\$ 145,592
Borrowed bond trading		69,497	
Derivatives other than for trading	14,430	14,083	134,366
Deferred gains on hedging instruments	9,569	15,980	89,100
Matured debentures	23,652	28,332	220,226
Other	62,325	45,645	580,308
Total	¥125,614	¥184,557	\$1,169,592

16. Liability for Employees' Retirement Benefits

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

The liability for employees' retirement benefits plans as of March 31, 2005 and 2004, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Projected benefit obligation	¥ 38,860	¥ 40,859	\$ 361,829
Fair value of plan assets	(16,751)	(18,839)	(155,969)
Unrecognized prior service cost	1,321	3,066	12,300
Unrecognized actuarial gain	(7,969)	(5,832)	(74,204)
Net liability	¥ 15,460	¥ 19,253	\$ 143,956

The components of net periodic benefit costs of the employees' retirement benefits plans for the years ended March 31, 2005 and 2004, are as follows:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Service cost	¥1,216	¥1,405	\$11,328
Interest cost	931	933	8,676
Expected return on plan assets	(323)	(476)	(3,010)
Amortization of prior service cost	(299)	(297)	(2,787)
Recognized actuarial loss	1,790	2,240	16,673
Net periodic retirement benefit costs	¥3,316	¥3,806	\$30,880

Assumptions used for the years ended March 31, 2005 and 2004 were as follows:

	2005	2004
Discount rate	1.9%	2.4%
Expected rate of return on plan assets		
Approved retirement annuities	0.2%	0.5%
Fund of welfare pension	2.0%	3.5%
Amortization period of prior service cost	9-12 years as average	9–12 years as average
	remaining service	remaining service
	period	period
Recognition period of actuarial gain/loss	5 years or average	5 years or average
	remaining service	remaining service
	period if less than	period if less than
	5 years	5 years

17. Stockholders' Equity

(1) Capital Stock and Capital Surplus

The authorized number of shares as of March 31, 2005 was 5,189 million shares of common stock and 943 million shares of non-voting, non-cumulative preferred stock. The number of treasury stock as of March 31, 2005, was 705 shares.

Japanese companies are subject to the Japanese Commercial Code (the "Code").

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

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

The Code allows Japanese companies to repurchase treasury stock and dispose of such treasury stock by a resolution of the Board of Directors. The repurchased amount of treasury stock cannot exceed the amount available for future dividends plus the amount of common stock, additional paid-in capital or legal reserve to be reduced in the case where such reduction was resolved at the general stockholders meeting.

Preferred stock as of March 31, 2005 and 2004, consisted of the following:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Preferred stock—authorized, 76,144 thousand			
shares; issued and outstanding, 48,144 thousand			
shares of fourth preferred stock	¥ 12,036	¥ 12,036	\$ 112,067
Preferred stock—authorized, 867,000 thousand			
shares; issued and outstanding, 866,667 thousand			
shares of fifth preferred stock	260,000	260,000	2,420,857
Total	¥272,036	¥272,036	\$2,532,924

(2) Retained Earnings

Under the Bank Law of Japan, an amount equivalent to at least 20% of the aggregate amount of cash dividends and certain other appropriations of retained earnings associated with cash outlays applicable to each period shall be appropriated as a legal reserve (a component of retained earnings) until such reserve and additional paid-in capital equals 100% of common stock. The amount of total additional paid-in capital and legal reserve that exceeds 100% of the common stock may be available for dividends by resolution of the stockholders. In addition, the Code permits the transfer of a portion of additional paid-in capital and legal reserve to common stock by resolution of the Board of Directors.

In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends. The amount of retained earnings available for dividends under the Code was ¥110,738 million (\$1,031,080 thousand) as of March 31, 2005, based on the amount recorded in the Parent Company's general books of account. In addition to the provision that requires an appropriation for a legal reserve in connection with the cash payment, the Code imposes certain limitations on the amount of retained earnings available for dividends.

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

18. Other Operating Income

Other operating income for the years ended March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Other operating income:			
Gain on sales of bonds	¥ 5,603	¥ 2,880	\$ 52,173
Gains on foreign exchange transactions	2,832	2,347	26,372
Gain on derivatives		4,999	
Other	17,595	6,522	163,835
Total	¥26,031	¥16,748	\$242,380

19. Other Income

Other income for the years ended March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Gain on sales of stocks and other securities	¥ 711	¥ 17	\$ 6,625
Reversal of reserve for possible loan losses	25,115	22,672	233,855
Reversal of reserve for credit losses on			
off-balance-sheet instruments	6,141		57,186
Other	16,752	4,946	155,983
Total	¥48,721	¥27,637	\$453,649

20. Other Operating Expenses

Other operating expenses for the years ended March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Other operating expenses:			
Amortization of debenture issuance costs	¥ 190	¥ 225	\$ 1,775
Loss on sales of bonds	1,304	4,586	12,144
Loss on derivatives	208		1,937
Other	1,896	474	17,659
Total	¥3,599	¥5,286	\$33,515

21. Other Expenses

Other expenses for the years ended March 31, 2005 and 2004, consisted of the following:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Provision for reserve for credit losses on			
off-balance-sheet instruments		¥ 7,268	
Write-off of claims	¥5,226	8,737	\$48,664
Loss on sales of stocks and other securities		2	
Loss on write-down of stocks	2	10	24
Loss on disposal of premises and equipment	62	165	585
Other	4,287	21,915	39,924
Total	¥9,579	¥38,101	\$89,197

22. Income Taxes

The Bank and its domestic subsidiaries are subject to Japanese national and local income taxes which, in the aggregate, resulted in normal effective statutory tax rates of approximately 40.6% and 43.7% for the years ended March 31, 2005 and 2004, respectively.

The Group files a tax return under the consolidated corporate-tax system from the fiscal year ended March 31,2004, which allows companies to base tax payments on the combined profits or losses of the parent company and its wholly owned domestic subsidiaries.

The tax effects of significant temporary differences and loss carryforwards which resulted in deferred tax assets and liabilities as of March 31, 2005 and 2004, were as follows:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Deferred tax assets:			
Tax loss carryforwards	¥ 90,846	¥ 269,103	\$ 845,873
Loss on devaluation of securities		23	
Reserve for possible loan losses	51,986	49,867	484,044
Other	26,101	26,832	243,030
Less valuation allowance	(153,464)	(331,169)	(1,428,910)
Total	15,469	14,656	144,037
Deferred tax liabilities:			
Unrealized gain on available-for-sale securities	(1,322)	(2,332)	(12,314)
Net deferred tax assets	¥ 14,147	¥ 12,323	\$ 131,723

A reconciliation between the normal effective statutory tax rates and the actual effective tax rates reflected in the accompanying consolidated statements of income for the years ended March 31, 2005 and 2004, is as follows:

	2005	2004
Normal effective statutory tax rate	40.6%	43.7%
Expenses not deductible for income tax purposes	(0.2)	(0.1)
Valuation allowance	(39.0)	(44.7)
Other—net	(1.5)	2.4
Actual effective tax rate	(0.1)%	1.3%

As of March 31, 2005, the Bank and a consolidated subsidiary have tax loss carryforwards which are available to be offset against taxable income in future years. These tax loss carryforwards, if not utilized, will expire as follows:

Year Ending March 31	Millions of Yen	Thousands of U.S. Dollars
2009	¥ 59,980	\$ 558,475
2010	61,358	571,313
2011	101,926	949,038
Total	¥223,265	\$2,078,826

23. Lease Transactions

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

Lease payments under finance leases were "¥1,290 million (\$12,012 thousand) and ¥1,055 million for the years ended March 31, 2005 and 2004, respectively.

Pro forma information of leased property such as acquisition cost, accumulated depreciation, obligation under finance lease, depreciation expense and interest expense of finance leases that do not transfer ownership of the leased property to the lessee on an "as if capitalized" basis for the years ended March 31, 2005 and 2004, was as follows:

Year Ended March 31, 2005

	Millions of Yen			Thou	usands of U.S. Do	llars
	Equipment	Other	Total	Equipment	Other	Total
Acquisition cost	¥5,320	¥690	¥6,010	\$49,535	\$6,425	\$55,960
Accumulated depreciation	2,482	180	2,662	23,112	1,683	24,795
Net leased property	¥2,837	¥509	¥3,347	\$26,423	\$4,742	\$31,165

Year Ended March 31, 2004

	Millions of Yen			
	Equipment Other To			
Acquisition cost	¥4,458	¥11	¥4,469	
Accumulated depreciation	2,511	10	2,521	
Net leased property	¥1,946	¥ 1	¥1,948	

Obligations under finance leases:

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Due within one year	¥1,277	¥ 808	\$11,891
Due after one year	2,078	1,140	19,355
Total	¥3,355	¥1,948	\$31,246

Depreciation expense under finance leases:

	Millions	Thousands of U.S. Dollars	
	2005	2004	2005
Depreciation expense	¥1,290	¥1,055	\$12,012

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

The amounts of acquisition cost, obligations and depreciation expense includes interest expense, due to its immateriality. The minimum rental commitments under noncancelable operating leases as of March 31, 2005 and 2004, were as follows:

	Millions	Thousands of U.S. Dollars	
	2005	2005	
Due within one year	¥10	¥7	\$ 96
Due after one year			6
Total	¥10	¥7	\$102

24. Derivatives

a. Derivatives Transactions

Derivative financial instruments dealt

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

Policy and purpose to use derivatives

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

As regards hedging activities to control interest rate risk arising from financial assets and liabilities, the Bank uses the deferral method of hedge accounting, in accordance with the main rules of JICPA Industry Audit Committee Report No. 24. The effectiveness of hedging for the purpose of offsetting market fluctuation is assessed as follows; the Bank specifies the items to be hedged such as deposits or loans and the hedging instruments to be used such as interest rate swaps and divides them into groups by remaining periods to maturity, and evaluates the hedging effectiveness within each of the groups.

Risk associated with derivatives

The two most significant derivatives-related risks are market and credit risks. Market risk can result in loss due to the volatility of factors such as interest rates and foreign exchange rates. Credit risk occurs when the counter-parties to a transaction fail to fulfill their obligations under a contract.

Risk control system for derivatives

The Bank strives to develop and maintain a proper risk control system to avert unexpected losses and to pursue reliable and sound business operations whereby the Bank takes risks commensurate with its financial strength to earn profits.

The Bank's basic philosophy of risk control is documented in "Master Policy for Risk Management". The Board of Directors establishes a basic framework of risk control, and within that framework responsible divisions control various risks, including market risk and credit risk. In addition, the Risk Management Division oversees the risk control system of the Bank as a whole, promotes the development of the system, measures and controls risks in a comprehensive manner. The Internal Audit Division audits the appropriateness and effectiveness of the risk control system. The Board of

Directors is informed about the risks by the responsible divisions and uses this information for management decisions in order to maintain and improve the risk control system.

For market risk, the maximum estimated loss is calculated on a daily basis using the value-at-risk method and the result is monitored based on specified limits. If an actual loss exceeds a maximum estimate, causal analysis is conducted. During the 245 business days from April 2004 to March 2005 and the 248 business days from April 2003 to March 2004, the actual value-at-risk figure in trading operations at the head office were estimated as follows:

Value-at-risk

	Millions	Thousands of U.S. Dollars	
	2005	2005	
Maximum	¥234	¥189	\$2,183
Minimum	65	49	608
Average	134	113	1,243

As to credit risk, the exposure is calculated by the current exposure method, the sum of the replacement cost and the potential cost in connection with expected changes in market conditions, and is controlled together with credit risk related to on-balance-sheet transactions such as lending. These

risks are managed in line with internal regulations. Credit risk equivalent amounts for capital adequacy ratio calculation purposes (based on a standard for domestic operations) as of March 31, 2005 and 2004, were estimated as follows:

Credit risk equivalent amount

	Millions	s of Yen	Thousands of U.S. Dollars		
	2005	2005 2004			
Currency related transactions	¥ 51,115	¥ 44,559	\$ 475,936		
Interest rate related transactions	153,240	122,407	1,426,818		
Credit derivatives	41,684	19,339	388,119		
Netting effect	(102,199)	(81,593)	(951,576)		
Total	¥ 143,840	¥104,711	\$1,339,297		

Supplementation to market-value calculation

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

b. Fair Value of Derivatives Transactions

The Bank and consolidated subsidiaries had the following derivatives contracts, which were quoted on listed exchanges, outstanding as of March 31, 2005 and 2004:

	Millions of Yen		Thousa U.S. D	ands of Oollars
March 31, 2005	Contract or Notional Amount	Fair Value	Contract or Notional Amount	Fair Value
Interest rate contracts:				
Futures written	¥ 56,526	¥ (48)	\$526,320	\$ (452)
Futures purchased	37,397	39	348,203	369
Options written	53,700	0	500,000	3
Options purchased	53,700	1	500,000	16
Bonds contracts:				
Futures written	9,885	(90)	92,046	(846)
Futures purchased	4,742	26	44,161	247
Futures options written	3,000	4	27,933	39
Futures options purchased	2,000	7	18,622	65
Equity contracts:				
Futures index written	754	(1)	7,021	(12)
Futures index purchased	1,818	(15)	16,928	(140)
Options index written	8,125	109	75,652	1,022
Options index purchased	830	3	7,728	35
March 31, 2004				
Interest rate contracts:				
Futures written	¥275,601	¥(221)		
Futures purchased	273,102	302	/	
Bonds contracts:				
Futures written	2,914	(74)		
Futures purchased	19,044	7		

The Bank and consolidated subsidiaries had the following derivatives contracts, which were not quoted on listed exchanges, outstanding as of March 31, 2005 and 2004:

	Millions of Yen			ands of Oollars
March 31, 2005	Contract or Notional Amount	Fair Value	Contract or Notional Amount	Fair Value
Interest rate contracts:				
Interest rate swaps:				
Receive fixed and pay floating	¥11,058,909	¥119,734	\$102,969,365	\$1,114,849
Receive floating and pay fixed	11,013,258	(98,984)	102,544,304	(921,641)
Receive floating and pay floating	260,303	156	2,423,681	1,454
Other written	126,627	(136)	1,179,029	(1,268)
Other purchased	45,055	221	419,507	2,061
Foreign exchange:				
Currency swaps	686,076	501	6,388,051	4,668
Forward exchange contracts written	216,176	(1,715)	2,012,820	(15,974)
Forward exchange contracts purchased	286,748	1,167	2,669,910	10,868
Options written	255,283	7,721	2,376,938	71,894
Options purchased	286,553	9,717	2,668,095	90,476
Credit derivatives				
Written	268,272	2,786	2,497,877	25,945
Purchased	294,665	(1,413)	2,743,622	(13,160)
March 31, 2004				/
Interest rate contracts:				
Interest rate swaps:				
Receive fixed and pay floating	¥ 9,422,587	¥115,752		
Receive floating and pay fixed	9,266,196	(97,519)		
Receive floating and pay floating	29,710	(45)		
Other written	89,798	(102)		
Other purchased	55,147	674		
Foreign exchange:			/	
Currency swaps	308,713	199	/	
Forward exchange contracts written	266,420	6,572	/	
Forward exchange contracts purchased	441,850	(6,527)		
Options written	142,191	4,387	/	
Options purchased	154,747	6,869		
Credit derivatives:			/	
Written	137,347	2,825		
Purchased	81,395	(570)	\bigvee	

Derivatives which qualify for hedge accounting are not included in the above tables.

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

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

25. Per Share of Common Stock

The reconciliation of the differences between basic and diluted net income per share ("EPS") for the years ended March 31, 2005 and 2004, is as follows:

	Millions of Yen	Thousands of Shares	Yen	U.S. Dollars
Year Ended March 31, 2005	Net Income	Weighted-average Shares	EF	PS .
Basic EPS—Net income available to common				
stockholders	¥86,428	2,834,870	¥30.48	\$0.28
Effect of dilutive securities—Preferred stocks	3,464	1,396,276		
Diluted EPS—Net income for computation	¥89,893	4,231,146	¥21.24	\$0.19
Year Ended March 31, 2004				
Basic EPS—Net income available to common				
stockholders	¥27,066	2,834,870	¥9.54	
Effect of dilutive securities—Preferred stocks	3,464	1,396,276		
Diluted EPS—Net income for computation	¥30,530	4,231,146	¥7.21	

26. Subsequent Events

1. Appropriation of Retained Earnings

The following appropriation of retained earnings as of March 31, 2005 was approved at the ordinary stockholders meeting held on June 23, 2005:

	Millions of Yen	Thousands of U.S. Dollars
Appropriations—Legal reserve	¥1,197	\$11,150
Year-end dividends:		
The fourth preferred, ¥5 (\$0.04) per share	240	2,241
The fifth preferred, ¥3.72 (\$0.03) per share	3,224	30,019
The common stock, ¥0.89 (\$0.00) per share	2,523	23,492
Total	¥7,185	\$66,902

Deloitte.

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

We have audited the accompanying consolidated balance sheets of Aozora Bank, Ltd. and consolidated subsidiaries as of March 31, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for the years then ended, all expressed in Japanese yen. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Aozora Bank, Ltd. and consolidated subsidiaries as of March 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in Japan.

As discussed in Note 2.e, the Company has changed the accounting for compound financial instruments. Embedded derivatives had been accounted for within the host financial assets or liabilities as a whole on an accrual basis until the previous year. From this fiscal year, embedded derivatives are marked-to-market separately from host financial assets or liabilities.

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

Deloitte Touche Tohnatsu

June 23, 2005

Member of **Deloitte Touche Tohmatsu**

Consolidated Financial Data

Income Analysis

Interest-Earning Assets and Interest-Bearing Liabilities Years Ended March 31

(Millions of Yen, %)

	A۱	erage baland	се	Intere	st income/ex	income/expense Return/rates			
	2005	2004	Change	2005	2004	Change	2005	2004	Change
Balance of interest-earning									
assets	4,300,350	4,817,059	(516,709)	76,583	80,651	(4,068)	1.78	1.67	0.11
Loans and bills discounted	2,783,452	3,187,965	(404,513)	54,286	61,654	(7,368)	1.95	1.93	0.02
Securities	1,097,806	1,189,070	(91,264)	9,982	5,789	4,193	0.90	0.48	0.42
Call loans and bills bought	65,286	103,994	(38,708)	30	37	(7)	0.04	0.03	0.01
Receivables under resale									
agreements	_	240	(240)	_	0	(0)	_	0.01	(0.01)
Receivables under securities									
borrowing transactions	253,487	194,910	58,577	63	61	2	0.02	0.03	(0.01)
Cash and due from banks	29,763	33,911	(4,148)	501	390	111	1.68	1.15	0.53
Balance of interest-bearing									
liabilities	4,099,008	4,553,795	(454,787)	17,688	16,914	774	0.43	0.37	0.06
Debentures	924,969	1,155,711	(230,742)	4,122	5,948	(1,826)	0.44	0.51	(0.07)
Deposits	1,897,171	2,032,486	(135,315)	7,982	8,778	(796)	0.42	0.43	(0.01)
Negotiable certificates of									
deposit	544,734	593,344	(48,610)	183	314	(131)	0.03	0.05	(0.02)
Borrowed money	30,114	21,720	8,394	331	492	(161)	1.10	2.26	(1.16)
Commercial paper	54	218	(164)	0	0	(0)	0.07	0.07	0.00
Call money and bills sold	456,717	579,872	(123,155)	636	223	413	0.13	0.03	0.10
Payables under repurchase	·		, , ,						
agreements	150,181	143,430	6,751	441	13	428	0.29	0.00	0.29
Payables under securities									
lending transactions	94,457	23,478	70,979	840	36	804	0.88	0.15	0.73

Fees and Commissions

Years Ended March 31

(Millions of Yen)

	2005	2004	Change
Net fees and commissions	10,035	8,732	1,303
Fees and commissions received	10,878	9,593	1,285
Debentures, deposits and loan operations	5,892	5,961	(69)
Foreign exchange operations	190	178	12
Securities-related operations	1,611	720	891
Agency services	784	957	(173)
Safekeeping and safe deposit box services	8	10	(2)
Guarantee operations	140	188	(48)
Fees and commissions paid	843	860	(17)
Foreign exchange operations	92	108	(16)

Trading Revenues

Years Ended March 31

(Millione of Van)

			(Millions or ferr)
	2005	2004	Change
Net trading revenues	5,803	2,865	2,938
Trading profits Gains on trading securities Gains on securities related to trading transactions Gains on trading-related financial derivatives Others	5,851 188 — 5,492 170	2,865 114 434 1,921 395	2,986 74 (434) 3,571 (225)
Trading losses Losses on trading securities Losses on securities related to trading transactions Losses on trading-related financial derivatives Others	47 	=	47 — 47 —

Other Operating Income Years Ended March 31

(Millions of Yen)

	2005	2004	Change
Net other operating income	22,432	11,462	10,970
Gains (losses) on foreign exchange transactions	2,832	2,347	485
Gains (losses) on bonds	4,311	(1,706)	6,017
Others	15,288	10,821	4,467

Non-Consolidated Business Results

Non-Consolidated Financial Highlights [Five-Year Summary]

Years Ended March 31

(Millions of Yen)

	2005	2004	2003	2002	2001
Operating income	113,816	105,335	101,633	100,984	270,720
Operating profits	43,733	7,309	7,437	13,706	98,971
Net income	86,859	31,854	22,875	18,563	99,690
Capital stock	419,781	419,781	419,781	419,781	419,781
Number of outstanding shares					
(in thousands)					
Common stock	2,834,870	2,834,870	2,834,870	2,834,870	2,834,870
The 2nd preferred stock					_
The 3rd preferred stock					_
The 4th preferred stock	48,144	48,144	48,144	48,144	48,144
The 5th preferred stock	866,667	866,667	866,667	866,667	866,667
Total stockholders' equity	609,524	527,582	496,918	476,166	459,690
Total assets	4,784,328	5,188,071	5,895,314	5,687,366	6,174,922
Debentures	851,993	1,058,973	1,473,126	1,470,193	2,472,528
Deposits	2,389,471	2,607,081	2,555,905	2,177,240	1,778,939
Loans and bills discounted	2,605,381	2,969,770	3,271,087	3,304,379	3,092,049
Securities	1,234,662	971,763	1,356,754	1,060,690	727,758
Total stockholders' equity per share					
_ (yen)	114.80	85.89	75.08	67.76	61.94
Dividends per share (yen)					
Common stock	0.89				_
The 2nd preferred stock					_
The 3rd preferred stock					_
The 4th preferred stock	5.00	5.00	5.00	5.00	5.00
The 5th preferred stock	3.72	3.72	3.72	3.72	1.86
(Interim dividends per share (yen))					
(Common stock)	(—)	(—)	(—)	(—)	()
(The 2nd preferred stock)					(—)
(The 3rd preferred stock)					(—)
(The 4th preferred stock)	()	(—)	(—)	(—)	(—)
(The 5th preferred stock)	(—)	(—)	(—)	(—)	(—)
Basic net income per share (yen)	29.41	10.01	6.84	5.32	36.31
Diluted net income per share (yen)	20.52	7.52	5.40	4.90	29.81
Dividend payout ratio (%)	3.03	_	<u> </u>	_	
Capital adequacy ratio					
(domestic standard) (%)	18.77	15.65	13.26	14.00	15.10
Number of employees	1,384	1,345	1,370	1,376	1,438

Notes: 1. Up to and including the fiscal year ended March 31, 2002, total stockholders' equity per share was calculated by dividing total stockholders' equity at the fiscal year-end, less the product of the number of preferred shares issued and outstanding at the fiscal year-end and the issue price, by the number of common shares issued and outstanding at the fiscal year-end (excluding treasury stock in the fiscal year ended March 31,

^{2.} Up to and including the fiscal year ended March 31, 2002, basic net income per share was calculated by dividing net income, less total dividends on preferred shares for the fiscal year ended March 31, 2002, by the average number of common shares issued and outstanding during the fiscal year (excluding treasury stock in the fiscal year ended March 31, 2002).

^{3.} From the fiscal year ended March 31, 2002, treasury stock is not included in capital stock. For this reason, total stockholders' equity per share, basic net income per share and diluted net income per share are calculated after deducting the number of shares of treasury stock from the outstanding number of shares.

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

^{5.} Number of employees does not include executive officers, locally hired overseas staff or the Bank's employees seconded to other firms.

Non-Consolidated Financial Statements

Non-Consolidated Balance Sheets (Unaudited) Aozora Bank, Ltd.

March 31, 2005 and 2004

	Millions	Thousands of U.S. Dollars	
ASSETS	2005	2005	
Cash and cash equivalents	¥ 171,363	¥ 337,977	\$ 1,595,559
Deposits with banks	39,255	45,588	365,505
Call loans and bills bought	100,923	25,431	939,699
Receivables under securities borrowing transaction	195,729	211,821	1,822,431
Commercial paper and monetary claims bought	52,948	67,290	493,004
Trading assets	354,706	488,449	3,302,663
Money held in trust	2,385	344	22,209
Investment securities	1,234,662	971,763	11,495,924
Loans and bills discounted	2,605,381	2,969,770	24,258,676
Foreign exchanges	1,477	1,355	13,754
Other assets	102,490	167,251	954,286
Premises and equipment	27,401	27,923	255,132
Deferred charges	150	153	1,401
Deferred tax assets	13,932	12,227	129,726
Customers' liabilities for acceptances and guarantees .	14,690	23,046	136,782
Reserve for possible loan losses	(133,168)	(162,323)	(1,239,932)
TOTAL	¥4,784,328	¥5,188,071	\$44,546,819

			T
	Millions of Yen		Thousands of U.S. Dollars
LIABILITIES AND STOCKHOLDERS' EQUITY	2005	2004	2005
LIABILITIES:			
Debentures	¥ 851,993	¥1,058,973	\$ 7,932,897
Deposits	2,389,471	2,607,081	22,248,337
Call money and bills sold	372,266	420,042	3,466,167
Payables under repurchase agreements	183,824	131,598	1,711,591
Payables under securities lending transactions	90,471	97,322	842,383
Commercial paper		5,000	
Trading liabilities	88,927	88,529	828,002
Borrowed money	47,200	27,900	439,479
Foreign exchanges	2	2	20
Other liabilities	119,114	174,237	1,109,069
Liability for employees' retirement benefits	15,066	18,846	140,280
Reserve for credit losses on off-balance-sheet instruments	1,776	7,908	16,536
Acceptances and guarantees	14,690	23,046	136,782
Total liabilities	4,174,803	4,660,488	38,871,543
STOCKHOLDERS' EQUITY:			
Capital stock			
Common stock	147,745	147,745	1,375,653
Preferred stock	272,036	272,036	2,532,924
Capital surplus	33,333	33,333	310,367
Retained earnings	154,482	71,087	1,438,384
Unrealized gain on available-for-sale securities	1,927	3,380	17,948
Total stockholders' equity	609,524	527,582	5,675,276
TOTAL	¥4,784,328	¥5,188,071	\$44,546,819

Non-Consolidated Statements of Income (Unaudited) Aozora Bank, Ltd.

Years Ended March 31, 2005 and 2004

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
INCOME:			
Interest on:			
Loans and bills discounted	¥ 51,752	¥ 60,230	\$ 481,862
Investment securities	11,319	6,318	105,392
Deposits with banks	460	390	4,285
Other	11,782	12,778	109,711
Fees and commissions	8,950	8,528	83,341
Trading income	5,851	2,865	54,481
Other operating income	22,586	13,628	210,307
Other income	43,364	24,609	403,765
Total income	156,067	129,351	1,453,144
EXPENSES: Interest on:			
Debentures	4,142	5,965	38,567
Deposits	8,165	9,093	76,029
Borrowings and repurchase agreements	965	714	8,986
Other	4,436	1,154	41,306
Fees and commissions	788	989	7,339
Trading expenses	47		441
Other operating expenses	3,778	5,174	35,181
General and administrative expenses	42,339	41,174	394,220
Other expenses	5,447	33,895	50,717
Total expenses	70,109	98,163	652,786
INCOME BEFORE INCOME TAXES	85,958	31,187	800,358
INCOME TAXES			
Current	(193)	(189)	(1,800)
Deferred	(708)	(477)	(6,592)
Total income taxes	(901)	(666)	(8,392)
NET INCOME	¥ 86,859	¥ 31,854	\$ 808,750

	Yen		U.S. Dollars
	2005	2004	2005
PER SHARE OF COMMON STOCK:			
Basic net income	¥29.41	¥10.01	\$0.27
Diluted net income	20.52	7.52	0.19
Cash dividends of the fourth preferred stock	5.00	5.00	0.04
Cash dividends of the fifth preferred stock	3.72	3.72	0.03
Cash dividends of common stock	0.89		0.00

Non-Consolidated Statements of Retained Earnings (Unaudited) Aozora Bank, Ltd.

Years Ended March 31, 2005 and 2004

	Millions of Yen		Thousands of U.S. Dollars
	2005	2004	2005
Balance at beginning of year	¥ 69,331	¥41,633	\$ 645,541
Cash dividends	(3,464)	(3,464)	(32,260)
Transfer to legal reserve	(692)	(692)	(6,452)
Net income	86,859	31,854	808,750
Balance at end of year	¥152,033	¥69,331	\$1,415,579

Reduction of Problem Loans and Analysis of Assets

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

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

In the fiscal year ended March 31, 2005, disclosed claims under the Financial Reconstruction Law amounted to ¥98.4 billion, an increase compared with the ¥88.7 billion disclosed at the end of the previous period. This increase was the result of changes in the borrower classification of a part of major borrowers, although the Bank promoted measures aiming at removing such assets from the Bank's balance sheet, including the collection of problem loans, the sale of some claims and write-offs.

As a result, the disclosed claim ratio rose from 2.95% at the end of the previous period to 3.75% as of March 2005.

However, most of the disclosed claims are secured with provision of reserves, guarantees and collateral, which makes the Bank's risk restrictive, in substantial terms.

Disclosed Claims under the Financial Reconstruction Law

(Billions of Yen)

			(Dilliono or Torr)
	2005	2004	Change
Disclosed claims under the Financial Reconstruction Law			
Bankrupt and similar credit	5.4	17.8	(12.4)
Doubtful credit	84.1	59.0	25.1
Substandard credit	8.9	11.9	(3.0)
Subtotal (A)	98.4	88.7	9.7
Normal credit	2,524.2	2,907.4	(383.2)
Total credit (B)	2,622.6	2,996.1	(373.5)
(A/B)	3.75%	2.95%	0.8%

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

The Bank has endeavored to effectively and rapidly reduce the amount of problem loans on its balance sheet, employing a variety of methods within an economically rational approach.

During the fiscal year ended March 31, 2005, of the disclosed claims under the Financial Reconstruction Law, doubtful credit and bankrupt and similar credit claims (hereinafter referred to as "doubtful and bankrupt and similar claims"), totaling ¥51.6 billion, were removed from the Bank's balance sheet as a result of collection and loan sales.

On the other hand, claims newly classified into the same two categories amounted to ¥64.2 billion. As a result, total doubtful and bankrupt and similar claims as of March 31, 2005, increased ¥12.7 billion compared with the end of the previous period.

The Bank will formulate a disposal plan for each individual obligor, thereby carrying out the removal of such claims from the Bank's balance sheet in a well-planned manner.

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

(Billions of Yen)

	2005	2004
Disposals through borrower		
liquidation	_	(2.3)
Disposals through borrower		
reorganization	(0.6)	(0.2)
Reproductions due to		
improvement in borrower		
performance	_	_
Loan sales to secondary market	(24.1)	(78.9)
Direct write-offs	0.2	3.8
Other (recovery, repayment)	(27.1)	(22.0)
Subtotal (A)	(51.6)	(99.6)
Claims newly classified as:		
Bankrupt and similar	1.0	11.5
Doubtful	63.3	58.0
Subtotal (B)	64.2	69.6
Total (A+B)	12.7	(30.0)

Notes: 1. Disposals through borrower liquidation: discharge and write-off of claims against borrowers undergoing bankruptcy liquidation; Disposals through borrower reorganization: discharge of claims against borrowers undergoing bankruptcy reorganization and abandonment of claims against borrowers undergoing private resolution; Other: recovery through disposal of collateral and improvement in borrower position.

 For claims written off, where the borrower subsequently undergoes legal or private resolution leading to claim discharge or abandonment, the written-off amount is reduced accordingly and then recorded as either a disposal through borrower liquidation or a disposal through borrower reorganization.

Self-Assessments, Write-Offs and Reserves

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

Self-assessments divide borrowers into five categories.

Assets are then classified into four categories according to the probability of collection, which is assessed by taking into account any underlying collateral, guarantees or other security.

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

		(70)
Definition of Borrower Categories	2005	2004
Normal	1.8	1.9
Watch list:		
Other watch list borrowers	17.3	17.1
Substandard borrowers		
(Ratio of reserve-to-		
unsecured)	85.6	92.2
Potentially bankrupt (Ratio of		
reserve-to-unsecured)	96.0	85.6
Substantially bankrupt and		
bankrupt (Ratio of reserve-		
to-unsecured)	(100.0)	(100.0)

Credit-related Expenses

In the fiscal year ended March 31, 2005, the Bank, as a result of the final disposal of problem loans, conducted loan writeoffs and specific reserve provisions. Due to the fact that sufficient general reserve provisions had been conducted up to the previous period and the fact that quality in assets had improved, reversal of general loan-loss reserve was made. As a result, the profit from credit-related expenses was ¥27.8 billion.

Credit-related Expenses

		(Billions of Yen)
	2005	2004
Expenses for the disposal of		
problem loans	10.3	38.9
Loan write-offs	4.2	8.3
Provision to specific reserve	6.0	17.3
Provision to (reversal of)		
country risk reserve	0.0	(0.7)
Loss on the sale of other		
receivables and other items	(0.0)	14.0
Provision to (reversal of) general		
loan-loss reserve	(38.1)	(32.4)
Credit-related expenses	(27.8)	6.5

Coverage Ratios of Disclosed Claims under the **Financial Reconstruction Law**

Total disclosed claims under the Financial Reconstruction Law amounted to ¥98.4 billion, while reserve provisions, collateral and guarantees amounted to ¥96.7 billion yen, resulting in a coverage ratio of 98.3%.

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

(Billions of Yen)

		,
	2005	2004
Disclosed claims under the Financial		
Reconstruction Law (A)	98.4	88.7
Normal credit	2,524.2	2,907.4
Total credit (B)	2,622.6	2,996.1
(A/B)	3.75%	2.95%
Credit secured:		
Reserve for possible loan		
losses (C)	29.3	29.9
Collateral and guarantees (D)	67.4	54.0
Total (E=C+D)	96.7	83.9
Coverage ratio (E/A)	98.3%	94.6%
Reserve ratio (C/(A-D))	94.5%	86.1%

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

Risk-Monitored Loans

In addition to disclosed claims under the Financial Reconstruction Law, the Bank also discloses risk-monitored loans under the Banking Law. As of March 31, 2005, riskmonitored loans (on a non-consolidated basis) amounted to ¥98.3 billion, up ¥9.6 billion from the previous period.

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

<Non-Consolidated>

(Billions of Yen)

	2005	2004
Risk-monitored loans:		
Loans to bankrupt companies	1.1	11.4
Past due loans	88.3	65.9
Loans overdue for three		
months or more	0.0	_
Restructured loans	8.9	11.3
Total (A)	98.3	88.7
Year-end balance of total loans (B)	2,605.4	2,969.8
(A/B)	3.8%	3.0%

<Consolidated>

(Billions of Yen)

		(201.0 01 101.1)
	2005	2004
Risk-monitored loans:		
Loans to bankrupt companies	2.4	11.5
Past due loans	88.3	66.0
Loans overdue for three		
months or more	0.0	_
Restructured loans	8.9	11.4
Total (A)	99.5	88.9
Year-end balance of total loans (B)	2,666.4	2,965.6
(A/B)	3.7%	3.0%

Self-Assessment, Disclosed Claims, Write-offs, Reserves and Risk-Monitored Loans (After Partial and Direct Write-Offs, Non-Consolidated Basis) As of March 31, 2005

(Billions of Yen) Disclosed claims under Reserve-to-unsecured-credit Borrower categories Reserve and coverage for claims under Reserve and Risk-monitored the Financial Reconstruction Law for self-assessment the Financial Reconstruction Law coverage ratio ratio Other Loans Loans to bankrupt Bankrupt borrowers Collateral/Guarantee coverage 5 1 Bankrupt and similar credit companies 1 Reserve 0.3 (100.0%)100.0% Substantially bankrupt borrowers 5.4 (Partial, direct write-offs of loans 7.8) Past due loans Collateral/Guarantee coverage 58.1 Potentially Doubtful credit Reserve 88.3 96.0% 98.8% bankrupt borrowers 84.1 Estimated collections 1.0 Loans overdue for three Collateral/Guarantee months or more 0.0 coverage Watch list Substandard credit 85.6% 92.4% Reserve Restructured loans borrowers 8.9 8.9 Estimated collections 0.7 (Normal credit 2,524.2) Normal horrowers

> Disclosed claims under the Financial Reconstruction Law 98 4

Total credit 2.622.6 Collateral/Guarantee coverage 67.4 29.3 17

Estimated collections

Total reserve 133.2

Reserve ratio for disclosed claims under the Financial Reconstruction Law 94.5%

Reserve and coverage ratio for disclosed claims under the Financial Reconstruction Law 98.3%

Risk-monitored loans 98.3

Reserve-to-unsecured-credit ratio = Reserve + (Claims — Collateral, guarantees, etc.) Reserve and coverage ratio = (Collateral, guarantees, etc. + Reserve) + Claims

<Definitions of Borrower Categories>

Business performance is strong and no special financial Normal

problems exist.

Borrowers that need to be monitored carefully because of weak business fundamentals, financial problems or Watch list

problematic lending conditions

Potentially Borrowers that are not currently bankrupt but are highly bankrupt likely to become bankrupt.

Borrowers that are substantially bankrupt but are not Substantially

bankrupt legally or practically bankrupt yet.

Bankrupt Borrowers that are legally or practically bankrupt.

<Definitions of Asset Classifications>

Assets that present no particular risk of collectability nor Category I

impairment of value

Category II Assets, including credits, which bear above-average risk of collectability.

Category III Assets that bear substantial risk of final collectability or impairment of value, and are likely to incur losses

Assets deemed to be uncollectable or valueless.

<Write-Off and Reserve Provision Rules>

Normal and watch list borrowers

Category IV

Based on historical bankruptcy rates, normal status borrowers, special attention borrowers and other watch list borrowers are classified and across-the-board provisions are made to the general loan-loss reserve.

Potentially bankrupt borrowers

For each borrower, the expected recovery amount of category III assets (non-secured portion) is estimated and a provision is made to the specific loan-loss reserve for the amount of shortfall. The expected recovery amount is the discounted present value of the estimated cash flows from future recovery of the loan principal.

In principle, the full amounts of category III and IV Substantially credits are written off directly. bankrupt and

bankrupt borrowers

< Definitions of Disclosed Claims under the Financial Reconstruction Law>

Bankrupt and similar credit

Bankrupt and similar credit refers to the credit of borrowers who have filed for bankruptcy, corporate reorganization, composition, etc., as well as those borrowers who are in an equivalent situation.

Doubtful credit Doubtful refers to credit with serious doubt concerning the recovery of principal and receiving of interest as contract provisions, because the borrower's financial condition and business results have worsened, although they have not reached the point of management collapse. Special attention refers to loans in arrears for more than

Substandard credit

Normal credit

three months or with mitigated conditions. Normal credit refers to credit to borrowers whose financial condition and business results have no particular problem and which are not categorized in any of the above

<Risk-Monitored Loans>

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

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

Past due loans Past due loans refer to non-accrual loans except those for which concessions on payment of interest were made in order to assist the reorganization of bankrupt companies and loans to them.

Loans overdue for three months or

Restructured loans

Loans overdue for three months or more refers to those loans, excluding loans to bankrupt companies and past due loans for which principal or interest remains unpaid

for at least three months Restructured loans refer to those loans, excluding loans to bankrupt companies, past due loans and loans overdue for three months or more for which agreement was made to provide reduction or a moratorium on

interest payments, or concessions in the borrower's favor on interest or principal payments or to waive claims for the purpose of assisting the reconstruction of insolvent

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

• Disclosed Claims

Disclosure:

Loans and other claims equivalent thereof (foreign exchange, acceptances and guarantees, suspense payments, as well as loaned securities that require notation [limited to only those subject to a usage and lending or lending agreement], etc.).

Disclosed: By borrower (by loan for substandard credit)

Risk-Monitored Loans

Disclosure: Loans only Disclosed: By loan

Risk Management System

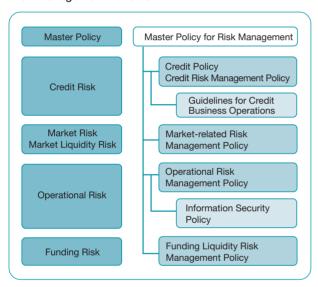
An Overview of Risk Management

Basic Policies

The objectives, basic rules and scope of Aozora Bank's overall risk management system as well as its awareness and management policies regarding credit risk, market-related risk, operational risk and other types of risk are clearly explained within the Bank's risk management policy.

By maintaining and structuring appropriate risk management systems, the Bank strives to avoid unforeseen losses while taking on risk to a level proportionate to the Bank's financial resources. Within the diverse business operations conducted by the Bank, proper risk management systems allow the Bank to obtain an adequate return for the risk it undertakes and facilitate sound management with a high degree of credibility.

Risk Management Policies



Risk Management System

As well as determining the basic rules for managing risk, the Board of Directors also sets the basic risk management framework for the Bank, including capital allocation and the setting of risk limits for the Bank.

Within this framework, the Chief Risk Officer (CRO) is responsible for unifying the risk management stance of the Bank as a whole, while each Chief Officer manages risks, including credit risk, market risk and operational risk, according to their particular characteristics.

In addition, the Internal Audit Division assesses the appropriateness and effectiveness of the overall risk management system, while the Credit Audit Division assesses credit risk on-site.

The Board of Directors, the Management Committee and other committees receive reports on the risk management situation from each risk jurisdiction, as well as from the Internal Audit Division and the Credit Audit Division, and they utilize this information overseeing the Bank's risk position and in management decision making. These management bodies also act to maintain and enhance the Bank's risk management system.

The New Products and Operations Committee deliberates on and issues final approval of major new products and operations. This approval process ensures that administrative procedures are properly followed from a risk management perspective.

Quantification of Integrated Risk

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

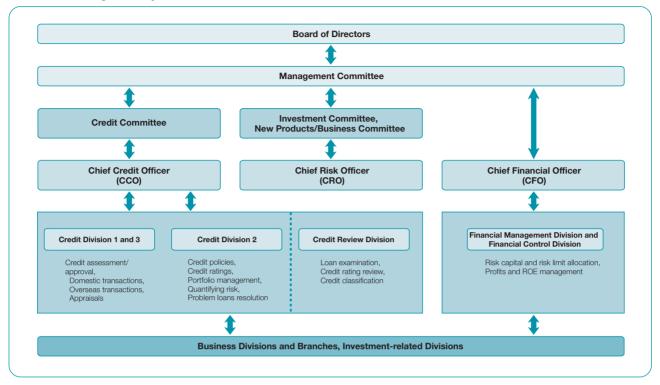
Capital Allocation

To maximize the profitability and efficiency of the Bank as a whole, the risk capital allocation system sets the amount of capital for individual business groups based on their risk tolerance and expected income.

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

Each group is responsible for conducting operations within the allocated risk capital. The CRO monitors the usage of capital by each business group and reports to senior management.

Credit Risk Management System



Note: The organization chart, including division names, is based on the new organizational structure of the Bank, which will be planned in September 2005.

Credit Risk Management

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

Credit Risk Management System

The Credit Committee discusses risk management issues and makes decisions on important policies and systems relating to credit risk; it also has the authority to approve individual credit and to delegate approval authority together with the power of re-delegation to the CCO. The Credit Committee consists of the Chairman, the President, the Vice Chairman, the CCO and others. Particularly significant decisions are made by the Management Committee or Board of Directors.

Credit Rating System

At Aozora Bank, with the exception of individual retail clients, customer credit ratings are determined based on the customer's financial condition, operating performance and a number of qualitative factors. Credit ratings are determined independently by each branch, and upon transaction screening, the Credit Division modifies the rating when necessary. The Credit Review Division performs periodical examinations and revises the ratings.

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

Credit Screening and Monitoring of Individual **Transactions**

At Aozora Bank, the person who is authorized by the CCO approves each transaction. In the Credit Division, the Credit Officer who is responsible for transactions (person in charge of each division or branch) and the Credit Officer who is in charge of researching industry segments work separately to maximize the effectiveness of credit analysis.

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

A firm's external valuation now has a greater impact on its creditworthiness. The Bank constantly monitors credit ratings assigned by credit rating agencies. This information is used to evaluate credit ratings and modify the account policy, if necessary, in a timely manner.

In relation to such credit screening and monitoring processes, the Credit Review Division performs internal audits of all divisions and branches through on-site monitoring to ensure adequate credit management.

Portfolio Management and Quantification of Credit Risk

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

The Bank maintains a balanced portfolio, ensuring that there is no over-concentration of exposure in any particular industry or corporate group.

Quantifying Credit Risk

Portfolio credit risk is dependent on which borrowers default and how such defaults occur. The Bank considers a range of factors affecting portfolio risk. These include the creditworthiness of each borrower based on the Bank's internal credit rating, exposure amount, losses arising from default and the level of correlation among borrowers (such as correlations between those in the same corporate group, and correlations with those in the same industry or in different industries). In light of these analyses, the Bank uses a Monte Carlo Simulation to calculate the volume of credit risk for the entire portfolio and for each business unit.

The volume of credit risk is controlled by the credit risk limit based on the allocated risk capital.

Market Risk Management

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

Market Risk Management System

Within the framework of integrated risk management, the Board of Directors decides the risk capital allocation for the entire Bank and for each business unit commensurate with market risk exposure. Market risk limits and loss limits are set in accordance with the capital allocation, and these unit limits are further subdivided into specific limits for each business division and department. The CRO independently and centrally monitors the usage of, and compliance with, risk and loss limits, and reports to the ALM Committee and the Board of Directors.

Quantifying Market Risk

Aozora Bank uses VaR to quantify market risk and as a basis for setting market risk limits. VaR is a statistical measure of estimated potential losses that could arise at a given confidence level. VaR serves as a common standard of measurement that estimates potential losses that could arise as a result of interest rate, stock price and exchange rate fluctuations.

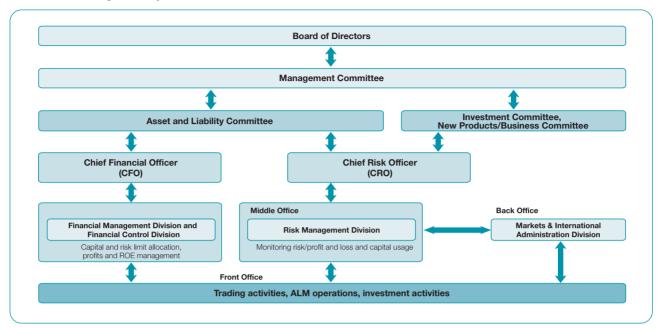
BACK TESTING

The Bank conducts back testing to verify the reliability of VaR calculations by comparing daily reported VaR with actual daily gains or losses. The results of the back testing for trading activities show that the actual daily losses exceeded daily VaR on only one of the 245 business days during the period from April 1, 2004, through March 31, 2005. These results support the reliability of the Bank's VaR model.

STRESS TESTING

To complement VaR, the Bank regularly conducts stress tests to prepare for volatile market movements that could exceed

Market Risk Management System



statistical estimates. The Bank calculates and analyzes potential losses that could arise from dramatic changes in interest rates, stock prices and exchange rates, or from a collapse of correlations among different risk categories.

Trading Activities

In the fiscal year ended March 31, 2005, the market risk level of trading activities for a VaR model with a one-day holding period and a one-sided confidence interval of 99% was a maximum of ¥234 million, a minimum of ¥65 million and an average of ¥134 million.

Asset-Liability Management (ALM)

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

In the fiscal year ended March 31, 2005, the ALM risk level for a VaR model with a one-day holding period and a onesided confidence interval of 99% was a maximum of ¥1.9 billion, a minimum of ¥0.6 billion and an average of ¥1.2 billion (weekly basis).

Interest Rate Sensitivity of Yen-Denominated Assets and Liabilities

(Billions of Yen)

	One year or less	One to five years	More than five years	Total
March 31, 2005	(0.1)	(0.2)	(0.6)	(0.8)
March 31, 2004	(0.3)	0.1	(1.2)	(1.4)

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

Other Operations

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

VaR for the Entire Bank

(Billions of Yen)

	Interest			
March 31, 2005	rate	Equity	Forex	Total
Trading	0.0	0.1	0.0	0.1
ALM	1.3	0.8	0.0	1.9
Others	0.0	1.9	0.0	1.9
Total	1.4	2.7	0.0	3.7

Note: The figures for total VaR do not represent the sum of individual components, due to correlations.

Operational Risk Management

Operational risk includes the potential for inconveniencing clients and causing significant losses. Recognizing the seriousness of these risks, the Bank has formulated the Operational Risk Management Policy, which clearly spells out the Bank's stance on this issue and the systems that have been put in place for managing such risk.

Banking operations involve exposure to a wide range of operational risk, including reputational risk, disaster risk and settlement risk, in addition to the types of risk previously mentioned. To manage these risks, for each type of risk the Bank identifies the organizational units responsible and the risk management systems in place. In addition, the CRO unifies the risk management systems across the entire Bank and carries out the integrated monitoring of operational risk, using quantitative and other methods.

Administrative Risk Management

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

Systems Risk Management

Aozora Bank is making concerted efforts to control systems risk, and has formulated a set of rules for systems risk management. The IT Management Division is making every effort to protect systems from natural disasters and other contingencies to ensure their stable operation. The Bank has also taken various steps to protect computer systems from a wide range of disasters and criminal activities to reduce systems risk.

Systems development and systems operation have been clearly separated to ensure adequate checks and balances between these two functions.

In the fiscal year under review, the Bank established a backup center for systems including core banking, providing even greater stability to the operation of the Bank's computer systems.

Legal Risk Management

Aozora Bank is responsible for taking proactive measures to prevent: (1) accidents and fraud, which may lead to breaches of laws and other regulations and standards; and (2) lawsuits and other disputes. The Bank is also responsible for rapidly identifying potential sources of disputes and lawsuits to facilitate appropriate responses and resolutions, and for taking necessary measures to prevent reoccurrence of such disputes. The Legal and Compliance Division supervises legal risk management.

Settlement Risk Management

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

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

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

Information Security Management

Information assets, including personal data, are just as important for a financial institution as tangible assets. However, information assets are vulnerable to a wide range of risks, such as accidents, disasters, system errors, unauthorized use, damage, theft, information leakage and data manipulation. Therefore, protecting information assets by such measures as information leakage prevention is critical to the fulfillment of the Bank's confidentiality obligations to its clients and the safeguarding of the entire organization. Guided by the Information Security Policy, Aozora Bank, including its consolidated subsidiaries, assesses the exposure

of its information assets to various risks and manages these risks to ensure the security of information systems.

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

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

Liquidity Risk Management

Funding Liquidity Risk Management

The Financial Management Division centrally monitors the funding liquidity risk of yen and foreign currency-denominated fund and puts limits on funding gaps for specific periods. The division ensures that the Bank's funding capabilities are sufficient to meet its contractual obligations. The Board of Directors and other management bodies approve the Sources and Uses Plan on an annual and monthly basis. The Financial Management Division reports liquidity status directly to the Bank's senior management on a daily basis.

Market Liquidity Risk Management

The Risk Management Division analyzes trading positions relative to market size and reports to the Bank's senior management on market liquidity risk. Trading positions are closely monitored to ensure that they do not become excessive.

Internal Audit Policy

At Aozora Bank, the Internal Audit Division, an autonomous body, assesses whether the risk management systems of the business units are functioning adequately and effectively. The Internal Audit Division not only identifies potential problems in clerical procedures, but also conducts assessments of the internal controls of business units and makes recommendations on improvements to potential problem areas. All business operations of the Bank and—subject to legal limitations—those of its subsidiaries and affiliates are subject to internal audits, the results of which are reported to the Board of Directors and to the Management Committee.

Non-Consolidated Financial Data

Debenture Operations

Outstanding Balance and Average Balance of Debentures Years Ended March 31

(Millions of Yen)

	20	05	2004			
	Term-end balance	Average balance	Term-end balance	Average balance		
Aozora debentures	811,131	883,771	1,007,731	1,092,647		
Discounted Aozora debentures	40,861	45,198	51,241	66,397		
Total	851,993	928,969	1,058,973	1,159,044		

Note: Debentures do not include debenture subscriptions.

Balance by Residual Period

March 31

(Millions of Yen)

		2005		2004			
	Total	Aozora Discounted	Discounted Aozora debentures	Total	Aozora Discounted	Discounted Aozora debentures	
Less than 1 year	330,072	289,248	40,823	562,415	511,439	50,976	
1 – 3 years	323,659	323,622	37	346,005	345,740	264	
3 – 5 years	198,256	198,256		150,536	150,536		
5 – 7 years	4	4		16	16		
Over 7 years		_					
Total	851,993	811,131	40,861	1,058,973	1,007,731	51,241	

Deposit Operations

Balance by Deposit Account Years Ended March 31

(Millions of Yen)

		2005			2004			
			Domestic	International		Domestic	International	
		Total	operations	operations	Total	operations	operations	
Deposits						-	-	
Liquid deposits	Average balance	401,948	401,948	_	481,985	481,985	_	
	(%)	(21.00)	(21.15)	_	(23.50)	(23.58)	_	
	Term-end balance	369,342	369,342	_	585,182	585,182	_	
	(%)	(19.71)	(19.96)	_	(28.42)	(28.59)	_	
Interest-bearing	Average balance	360,800	360,800	_	423,534	423,534	_	
deposits	(%)	(18.85)	(18.99)	_	(20.65)	(20.72)	_	
	Term-end balance	324,831	324,831	_	477,115	477,115	_	
	(%)	(17.33)	(17.56)	_	(23.17)	(23.31)	_	
Time deposits	Average balance	1,495,545	1,495,545	_	1,559,401	1,559,401	_	
(in general)	(%)	(78.12)	(78.71)	_	(76.01)	(76.31)	_	
	Term-end balance	1,469,712	1,469,712	_	1,450,446	1,450,446	_	
	(%)	(78.43)	(79.44)	_	(70.45)	(70.86)	_	
Deregulated	Average balance	1,321,993	1,321,993		1,335,812	1,335,812	/	
interest rate time	(%)	(69.06)	(69.58)		(65.12)	(65.37)		
deposits (fixed)	Term-end balance	1,316,502	1,316,502		1,273,686	1,273,686		
	(%)	(70.25)	(71.15)		(61.86)	(62.22)		
Deregulated	Average balance	173,551	173,551		223,588	223,588		
interest rate time	(%)	(9.07)	(9.13)		(10.90)	(10.94)		
deposits (floating)	Term-end balance	153,210	153,210		176,760	176,760		
	(%)	(8.18)	(8.28)		(8.58)	(8.64)		
Others	Average balance	16,842	2,591	14,251	10,069	2,210	7,858	
	(%)	(0.88)	(0.14)	(100.00)	(0.49)	(0.11)	(100.00)	
	Term-end balance	34,936	11,143	23,793	23,332	11,354	11,977	
	(%)	(1.86)	(0.60)	(100.00)	(1.13)	(0.55)	(100.00)	
Total	Average balance	1,914,336	1,900,085	14,251	2,051,457	2,043,598	7,858	
	(%)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	
	Term-end balance	1,873,991	1,850,198	23,793	2,058,961	2,046,983	11,977	
	(%)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	
Negotiable certificates	Average balance	544,734	544,734	_	593,344	593,344	_	
of deposit	Term-end balance	515,480	515,480	_	548,120	548,120	_	
Total	Average balance	2,459,070	2,444,819	14,251	2,644,801	2,636,942	7,858	
	Term-end balance	2,389,471	2,365,678	23,793	2,607,081	2,595,103	11,977	

Notes: 1. Time deposits (in general) = Time deposits

Deregulated interest rate time deposits (fixed) = Deregulated interest rate time deposits for which the interest up to the due date is determined when the deposits are made.

Deregulated interest rate time deposits (floating) = Deregulated interest rate time deposits for which the interest varies according to changes in market interest rates during the period of deposit.

^{2.} Liquid deposits = Deposits at notice + Ordinary deposits + Current deposits

^{3.} Average balance of domestic offices' foreign-currency denominated transactions in the international operations sector has been computed by the daily current method.

Balance of Time Deposits by Residual Period

(Millions of Yen)

		2005		2004			
	Total	Deregulated interest rate (fixed)	Deregulated interest rate (floating)	Total	Deregulated interest rate (fixed)	Deregulated interest rate (floating)	
Less than 3 months	219,005	206,695	12,310	251,971	228,916	23,055	
3 – 6 months	67,683	65,683	2,000	114,082	84,372	29,710	
6 months – 1 year	104,044	100,094	3,950	148,565	119,101	29,464	
1 – 2 years	354,077	314,777	39,300	144,753	104,473	40,280	
2 – 3 years	407,614	396,214	11,400	347,738	310,938	36,800	
More than 3 years	317,286	233,036	84,250	443,335	425,885	17,450	
Total	1,469,712	1,316,502	153,210	1,450,446	1,273,686	176,760	

Outstanding Balance by Depositor

March 31

(Millions of Yen, %)

	20	05	2004		
	Balance	Share	Balance	Share	
Corporations	421,172	22.61	612,145	29.82	
Individuals	1,143,527	61.40	1,100,750	53.61	
Public sector	17,261	0.93	20,616	1.00	
Financial institutions	280,584	15.06	319,612	15.57	
Total	1,862,546	100.00	2,053,123	100.00	

Note: The above balance does not include negotiable certificates of deposit and deposits in Japan Offshore Market accounts.

Loan Operations

Outstanding Balance of Loans

Years Ended March 31

(Millions of Yen)

		2005				2004	
		Total	Domestic operations	International operations	Total	Domestic operations	International operations
Loans on deeds	Average balance Term-end balance	2,209,732 2,114,757	2,138,136 2,022,296	71,596 92,461	2,477,061 2,359,847	2,423,986 2,309,168	53,075 50,679
Loans on notes	Average balance Term-end balance	372,219 292,625	371,537 292,195	681 429	543,559 440,667	542,919 439,716	639 950
Overdrafts	Average balance Term-end balance	165,393 191,817	165,393 191,817		169,352 162,944	169,352 162,944	_
Bills discounted	Average balance Term-end balance	4,748 6,181	4,748 6,181		4,792 6,310	4,792 6,310	
Total	Average balance Term-end balance	2,752,094 2,605,381	2,679,816 2,512,490	72,277 92,891	3,194,765 2,969,770	3,141,050 2,918,139	53,714 51,630

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

Balance by Residual Period

March 31

(Millions of Yen)

(Millions of Yi							
	2005			2004			
	Total	Fixed interest	Floating interest	Total	Fixed interest	Floating interest	
Less than 1 year	979,389			1,045,331			
1 – 3 years	617,630	386,056	231,573	677,733	383,670	294,063	
3 – 5 years	619,196	287,077	332,119	770,410	501,211	269,199	
5 – 7 years	183,110	69,781	113,329	212,790	93,919	118,871	
Over 7 years	205,521	122,635	82,886	262,906	159,824	103,081	
Indefinite period	532	_	532	596	_	596	
Total	2,605,381			2,969,770			

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

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

Breakdown of Loans and Bills Discounted by Industry

March 31

(Number of Borrowers, Millions of Yen, %)

		2005			2004	
	Number of borrowers	Balance of loans	Share	Number of borrowers	Balance of loans	Share
Loans by domestic offices						
(excluding Japan Offshore Market accounts)	5,166	2,567,714	100.00	5,505	2,932,246	100.00
Manufacturing	507	372,547	14.51	548	439,428	14.99
Agriculture, forestry and fisheries	6	5,629	0.22	9	7,752	0.26
Mining	7	1,660	0.07	8	2,310	0.08
Construction	101	109,054	4.25	100	129,947	4.43
Utilities	28	18,098	0.70	33	20,701	0.71
Information and communications	129	64,173	2.50	156	71,279	2.43
Transport	150	191,147	7.44	170	244,762	8.35
Wholesale and retail	422	231,461	9.01	496	302,888	10.33
Financial and insurance	104	332,772	12.96	104	423,543	14.44
Real estate	411	541,991	21.11	405	574,253	19.58
Various services	640	425,430	16.57	688	487,851	16.64
Local government	4	8,206	0.32	3	5,550	0.19
Others	2,657	265,540	10.34	2,785	221,977	7.57
Loans by overseas offices						
(including Japan Offshore Market accounts)	26	37,667	100.00	28	37,523	100.00
Governments and official institutions	_	_	_	_		_
Financial institutions	_	_	_	_	_	_
Commercial and industrial	26	37,667	100.00	28	37,523	100.00
Others	_	_	_	_	_	_
Total	5,192	2,605,381		5,533	2,969,770	

Breakdown of Loans and Bills Discounted by Collateral

March 31

(Millions of Yen)

	2005	2004
Securities	61,149	31,429
Claims	516,932	564,472
Merchandise	_	10
Land and buildings	576,567	643,004
Factories	1,037	1,233
Foundations	178,054	200,002
Vessels	34,432	27,516
Others	632,805	782,205
Total	2,000,979	2,249,874
Guarantees	132,238	173,363
Credits	472,163	546,532
Total	2,605,381	2,969,770

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

Write-Off of Loans

March 31

(Millions of Yen)

	2005	2004
Write-off of loans	4,239	8,331

Reserves for Possible Loan Losses

Years Ended March 31

(Millions of Yen)

2005					2004					
			Reduction	during year				Reduction during year		
	Balance at beginning		Used for specific		Balance at	Balance at beginning		Used for specific		Balance at
	of year	Provision	purpose	Other	end of year	of year	Provision	purpose	Other	end of year
General reserve for										
possible loan losses	127,890	95,962	_	127,890	95,962	167,564	127,890	_	167,564	127,890
Specific reserve for possible loan losses	33,769	36.523	3,292	30.477	36.523	30.412	33.769	13.963	16.449	33.769
Possible loan losses related	00,100	00,020	0,202	00,111	00,020	00,112	00,100	10,000	10,110	00,100
to non-residents	_	_	_	_	_	_	_	_	_	_
Provision for country risk reserve	663	683	_	663	683	1,343	663	_	1,343	663

Country Risk Reserve March 31

(Millions of Yen)

	2005	2004
Indonesia	7,168	7,780
Total	7,168	7,780
(Percentage of total assets)	(0.14%)	(0.14%)

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

Securities

Outstanding Balance and Average Balance of Securities Held Years Ended March 31

(Millions of Yen)

			2005			2004	
		Total	Domestic operations	International operations	Total	Domestic operations	International operations
Total	Average balance	1,150,573 (100.00)	852,044 (100.00)	298,529 (100.00)	1,195,745 (100.00)	1,033,848 (100.00)	161,897 (100.00)
	Term-end balance	1,234,662	754,853 (100.00)	479,808 (100.00)	971,763 (100.00)	838,862 (100.00)	132,900 (100.00)
National government bonds	Average balance (%)	736,637 (64.02) 538,182	736,637 (86.45) 538,182	— — — —	909,623 (76.07) 728,612	909,623 (87.98) 728,612	— — — — — — — — — — — — — — — — — — —
Local government bonds	(%)	(43.59) 6,025 (0.52)	(71.30) 6,025 (0.71)		(74.98) 21,723 (1.82)	(86.86) 21,723 (2.10)	
	Term-end balance (%)	5,964 (0.48)	5,964 (0.79)	_ _	4,234 (0.44)	4,234 (0.50)	_
Short-term corporate bonds	Average balance (%)	_ _ _	_ _ _	_ _ _	_ _ _	_ _ _	_ _ _
Corporate bonds	(%)	59,361 (5.16) 65,924	59,361 (6.97) 65,924		74,869 (6.26) 65,351	74,869 (7.24) 65,351	
Stocks	(%)	(5.34) 8,237 (0.72) 7,803 (0.63)	(8.73) 8,237 (0.97) 7,803 (1.03)		(6.72) 8,561 (0.72) 8,570 (0.88)	(7.79) 8,561 (0.83) 8,570 (1.02)	
Others	Average balance (%)	340,311 (29.58) 616,787 (49.96)	41,782 (4.90) 136,978 (18.15)	298,529 (100.00) 479,808 (100.00)	180,967 (15.13) 164,993 (16.98)	19,070 (1.85) 32,093 (3.83)	161,897 (100.00) 132,900 (100.00)

Notes: 1. Total for Others is the sum of Domestic operations and International operations.

Balance of Securities by Residual Period

March 31

(Millions of Yen)

		2005							20	04		
	National government bonds	Local government bonds	Short-term corporate bonds	Corporate bonds	Stocks	Others	National government bonds	Local government bonds	Short-term corporate bonds	Corporate bonds	Stocks	Others
Less than 1 year	399,960	51	_	13,136	/	17,116	551,144	1	_	14,705		12,401
1 – 3 years	5,054	359	_	29,430		69,841	76,503	123	_	24,868	/	83,863
3 – 5 years	20,855	1,793	_	19,653		141,473	80,598	598	_	20,576		15,626
5 – 7 years	5,215	316	_	3,704		8,923	_	417	_	2,214	/	442
7 – 10 years	5,114	2,978	_	_		16,055	20,365	2,604	_	2,987		7,258
Over 10 years	101,983	463	_	_		123,580	_	489	_	_	/	_
Indefinite period	_	_	_	_	7,803	239,794	_	_	_	_	8,570	45,400
Total	538,182	5,964	_	65,924	7,803	616,787	728,612	4,234	_	65,351	8,570	164,993

^{2.} Average balance of domestic offices' foreign-currency denominated transactions in international operations is computed by the daily current method.

Derivative Transactions

Hedge accounting for interest rate risk

• Since the fiscal year ended March 31, 2004, the Bank applied hedge accounting in accordance with the rules stipulated in JICPA Industry Audit Committee Report No. 24.

Hedge accounting for exchange rate risk

- Since the fiscal year ended March 31, 2004, the Bank applied hedge accounting in accordance with the rules stipulated in JICPA Industry Audit Committee Report No. 25.
- Notes: 1. Unrealized gains or losses on hedging instruments that qualify for hedge accounting are shown below.
 - 2. Valuation gains (losses) from interest rate swaps included accrued interest income on interest rate swap transactions of ¥293 million for the fiscal year ended March 31, 2005, and ¥160 million for the fiscal year ended March 31, 2004.
 - 3. Valuation gains (losses) from currency swaps included accrued interest expenses on currency swap transactions of ¥758 million for the fiscal year ended March 31, 2005, and ¥86 million for the fiscal year ended March 31, 2004.

Interest Rate Swaps

Years Ended March 31

(Millions of Yen)

		2005				2004				
	Contrac	t amount		Valuation	Contrac	t amount		Valuation		
		Over one year	Fair value	gains (losses)		Over one year	Fair value	gains (losses)		
Total	751,300	640,300	1,046	1,046	412,400	412,400	(1,658)	(1,658)		
Receivable fixed rate/										
Payable floating rate	751,300	640,300	1,046	1,046	412,400	412,400	(1,658)	(1,658)		
Receivable floating rate/										
Payable fixed rate	_	_	_	_	_	_	_			
Receivable floating rate/										
Payable floating rate	_	_		_	_	_		_		

Currency Swaps

Years Ended March 31

(Millions of Yen)

		20	05		2004			
	Contract amount			Valuation	Contract amount			Valuation
		Over one year	Fair value	gains (losses)		Over one year	Fair value	gains (losses)
Total	213,726 31,683		(351)	(351)	63,390	31,695	(110)	(110)

Capitalization

History of Capitalization

(Millions of Yen)

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

Major Shareholders (As of March 31, 2005)

a. Common Stock

	Number of shares held	Percentage of
	Number of shares held	total outstanding shares
Cerberus NCB Acquisition, L.P., General Partner		
Cerberus Aozora GP LLC	1,753,328 thousand	61.84%
ORIX Corporation	425,041	14.99
Tokio Marine & Nichido Fire Insurance Co., Ltd	425,041	14.99
THE NISHI-NIPPON CITY BANK, LTD	11,360	0.40
Shinkin Central Bank	5,680	0.20
The Shinkumi Federation Bank	5,680	0.20
The Rokinren Bank	5,680	0.20
THE MICHINOKU BANK, LTD	5,680	0.20
The Hachijuni Bank, Ltd	5,680	0.20
Suruga Bank Ltd	5,680	0.20
The Bank of Kyoto, Ltd	5,680	0.20
The Chugoku Bank, Limited	5,680	0.20
The Hiroshima Bank, Ltd	5,680	0.20
The Yamaguchi Bank, Ltd	5,680	0.20
THE BANK OF FUKUOKA, LTD	5,680	0.20
THE SHINWA BANK, LTD	5,680	0.20
Momiji Bank, Ltd	5,680	0.20
Others	146,260	5.18
Total	2,834,870	100.00

b. The 4th Preferred Stock

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

c. The 5th Preferred Stock

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

Corporate Data

Corporate History

	Т	
April	1957	Established as The Nippon Fudosan Bank, Limited (capital: ¥1 billion) in accordance with the
		Long-Term Credit Bank Law
November		Started issuance of debentures
September	1958	Started issuance of discount debentures
July	1964	Started foreign exchange business as an authorized foreign exchange bank
September		Listed stock on the Tokyo Stock Exchange
February	1970	Listed stock on the Osaka Securities Exchange
October	1977	Changed name to The Nippon Credit Bank, Ltd.
May	1991	Established NCB Private Equity Co., Ltd. (currently Aozora Investment Co., Ltd.)
February	1994	Established The Nippon Credit Trust Bank, Ltd. (currently Aozora Trust Bank, Ltd.), the first domestic subsidiary classified as other type of business
December	1998	Started special public management in accordance with the Financial Reconstruction Law and terminated listing of stock on the Tokyo Stock Exchange and the Osaka Securities Exchange
June	1999	Established NCB Servicer Co., Ltd. (currently AOZORA Loan Services Co., Ltd.), and commenced servicer operations in September 1999
June	2000	Share Purchase Agreement regarding the transfer of the Bank's shares was signed between Deposit Insurance Corporation and SOFTBANK CORP., ORIX Corporation, The Tokio Marine an Fire Insurance Co., Ltd. (currently Tokio Marine & Nichido Fire Insurance Co., Ltd.), and other financial institutions
September		Ended special public management
November		Commenced telephone banking services
January	2001	Changed name to Aozora Bank, Ltd.
April		Launched Aozora Direct Time Deposit as a product exclusively available through telephone banking
October	2002	Commenced over-the-counter sales of personal pension life insurance policies
March	2003	Moved headquarters
September		Through a common stock tender offer conducted in accordance with the Securities Exchange Law, all common stock of the Bank held by SOFTBANK CORP. was transferred to the ownershi of Cerberus NCB Acquisition, L.P., General Partner Cerberus Aozora GP LLC
October	2004	Launched Aozora Pocket Time Deposit (permits partial withdrawals before maturity)
June	2005	Launched Excellent First time deposit (callable time deposit)

Business Activities

Debentures

Issuance of debentures and discounted debentures

Deposits

Deposits

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

Certificates of deposit

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

Lending and guarantee of liabilities

Loans, discounts on promissory notes, guarantee of liabilities for equipment funds and long-term operating fund services Loans for long-term funds (term exceeding six months), other than equipment funds and long-term operating funds Loans for short-term funds (term of less than six months), limited to the total amount of deposits or corresponding funds Discounts on promissory notes, guarantee of liabilities and acceptance of promissory notes

Securities

Securities investment business

Underwriting of public bonds

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

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

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

Consignment business for soliciting or managing public bonds

Trust business for secured corporate bonds

Domestic exchange

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

Foreign exchange

Remittance to foreign countries and other foreign currency-related businesses

Other services

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

Receipt of public funds of local public entities, including Tokyo

Agency business for: Japan Finance Corporation for Small and Medium Enterprise; Organization for Workers' Retirement Allowance Mutual Aid; Government Pension Investment Fund; Japan National Oil Corporation; and Welfare and Medical Service Agency

Custody services

Rental of safe-deposit boxes

Lending of securities

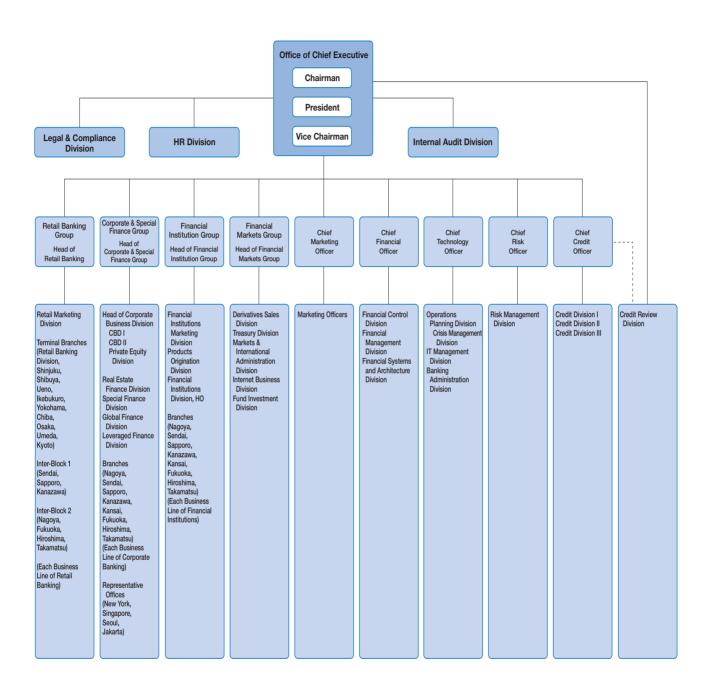
Commercial paper

Interest rate, currency and other derivative transactions

Over-the-counter sales of insurance products

Organization Chart

(To be planned in September 2005)



Office Directory

(As of July 20, 2005)

Overseas Network

Representative Offices

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Chief Representative Toshiki Yoshizawa

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Singapore Representative Office

Head of South East Asia Masanao Kobayashi

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Seoul Representative Office

Senior Representative Masayuki Ohga

Address

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Tel: +82-2-734-8120 Fax: +82-2-734-8126

Jakarta Representative Office

Chief Representative Hiroshi Matsumoto

Address

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Shinjuku-ku, Tokyo 160-0022

Ikebukuro

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

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

Kyoto

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

Kansai

5-7, Honmachi 3-chome, Chuo-ku, Osaka 541-0053 Tel: 06-6263-2512

Osaka

2-3, Namba 2-chome, Chuo-ku, Osaka 542-0076 Tel: 06-4708-2051

Umeda

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

Hiroshima

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

Takamatsu

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

Fukuoka

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

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

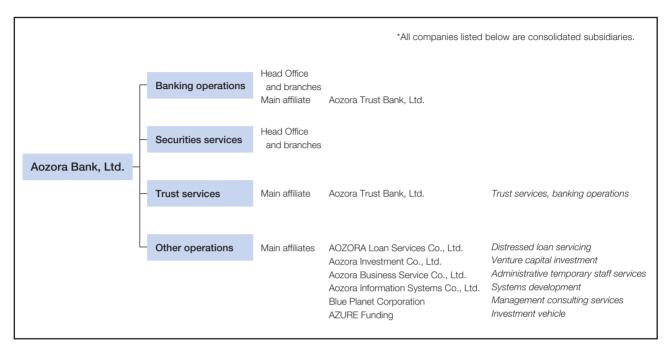
Ueno

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

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

Business Network

(As of March 31, 2005)



Subsidiaries at a Glance

(As of June 23, 2005) (Millions of Yen, %)

Company Name	Location	Business Activities	Established	Capital	Aozora Bank Share- holding	Group Share- holding
Aozora Trust Bank, Ltd.	3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo	Trust services, banking operations	February 28, 1994	5,437	85.1	
AOZORA Loan Services Co., Ltd.	13-5, Kudan-kita 1-chome, Chiyoda-ku, Tokyo	Distressed loan servicing	June 18, 1996	500	67.6	_
Aozora Investment Co., Ltd.	3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo	Venture capital investment	May 17, 1991	20	100.0	_
Aozora Business Service Co., Ltd.	3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo	Administrative temporary staff services	September 21, 1987	10	100.0	_
Aozora Information Systems Co., Ltd.	17-11, Kanda-Nishikicho 3-chome, Chiyoda-ku, Tokyo	Systems development	April 1, 1967	150	100.0	_
AOZORA SOFTWARE CORPORATION	17-11, Kanda-Nishikicho 3-chome, Chiyoda-ku, Tokyo	Systems development	May 9, 1973	12		100.0
Aozora Computer Co., Ltd.	21, Nikkocho 1-chome, Fuchu-shi, Tokyo	Computer operation	April 1, 1991	20	5.0	95.0
Blue Planet Corporation	17-11, Kanda-Nishikicho 3-chome, Chiyoda-ku, Tokyo	Management consulting services	April 20, 2001	370	55.1	_
AZURE Funding	Cayman Islands, British West Indies	Investment vehicle	August 6, 2004	0	_	

Directors and Auditors, Executive Officers

(As of July 19, 2005)

Directors and Auditors

Chairman

Michael E. Rossi*

President

Hirokazu Mizukami*

Vice Chairman

Peter C. Hagan*

Director

Yoshihiko Miyauchi

Director

James Danforth Quayle

Director

Edward G. Harshfield

Director

Frank W. Bruno

Director

Jake Garn

Director

Yoichiro Iwama

Director

Pieter Korteweg

Director

Lawrence B. Lindsey

Director

John L. Steffens

Director

John C. Stomber

Director

Kiyoshi Tsugawa

Standing Corporate Auditor

Ken Shigihara
Corporate Auditor
Mitch R. Fulscher
Corporate Auditor

Akira Tachimoto

Executive Officers

Senior Managing Executive Officer

Yuji Inagaki

Senior Managing Executive Officer

Izumi Ogura

Senior Managing Executive Officer

David Hackett

Senior Managing Executive Officer

William Chute

Senior Managing Executive Officer

Lee Millstein

Senior Managing Executive Officer

Takeyoshi Morikawa

Senior Managing Executive Officer

Hiroshi Jinno

Senior Managing Executive Officer

Carlos A. Erchuck

Managing Executive Officer

Tomoaki Ishii

Managing Executive Officer

Hirokazu Takino
Executive Officer
Ryoichi Kawai
Executive Officer
Tadaaki Satoyoshi
Executive Officer

Katsutoshi Ishida

^{*} Concurrently serving as Executive Officer

AOZORA BANK, LTD.

3-1, Kudan-minami 1-chome, Chiyoda-ku, Tokyo 102-8660, Japan Tel: +81-3-3263-1111

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

Forward-Looking Statements

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

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Aozora Bank, Ltd.

AOZORA BANK, LTD.

