Financial Section

Operating Environment

The consolidated fiscal period ended March 31, 2002—fiscal 2001—proved to be challenging. Overseas, economic and financial conditions in the United States were already characterized by cool capital investment activity and sluggish consumer spending when the execution of multiple terrorist attacks on September 11, 2001, exacerbated fears of recession in that country and on a global scale. However, official measures, such as additional interest rate reductions by the Federal Reserve Board, helped restore stability and set one of the world's primary economic engines back on track. Meanwhile, the European and Asian economies pulled out from their previous downward orientation.

In Japan, however, the situation remained gloomy. The employment environment deteriorated further, typified by an unemployment rate that hit a record 5.5%, albeit only temporarily. Consumer spending was slow. But the economic horizon brightened a little in early 2002 with signs that better business conditions in the United States were having a parallel effect in Japan on export activity and domestic production levels.

The domestic finance industry saw such developments as the gradual expansion of quantitative deregulation measures initially implemented in March 2001. The long-term interest rate hovered around 1%. The Nikkei Stock Average broke through the 10,000 mark in the wake of the September 11 terrorist attacks but made a gradual recovery by the fiscal year-end. In the foreign exchange market, the yen held steady in the mid-120s against the U.S. dollar in the first half of fiscal 2001, but fell to 130 around the end of 2001.

Creation of Financial Group with Trust Banking at Its Core

In October 2001, Chuo Mitsui announced plans to augment a series of management restructuring efforts with an increase in capitalization so as to better demonstrate the Bank's specialization, respond more accurately to clients' needs and strengthen its financial standing amid the challenging economic and financial conditions that prevailed.

Specifically, Mitsui Trust Holdings was established as a holding company under which Chuo Mitsui and its wholly owned subsidiary Sakura Trust—renamed Mitsui Asset in February 2002—would operate. In March 2002, the pension and securities trust businesses of Chuo Mitsui were transferred to Mitsui Asset through a company split.

Securing the cooperation of companies with which it maintains close ties, Chuo Mitsui procured funds through the issue of preferred shares, worth ¥57.1 billion, and Mitsui Asset acquired external equity participation totaling ¥39.0 billion, of which ¥25.5 billion was booked for the fiscal year in review.

Utilizing the new structure derived through this series of management restructuring efforts, Mitsui Trust Holdings aims to oversee "a corporate group that meets clients' expectations and contributes widely to society with the efficient and highly transparent management of a financial organization distinguished from the competition by its trust-banking core and its wide selection of excellent trust products and services." The Company will also strive to realize maximum service value from members of Mitsui Trust Financial Group and raise shareholder value.

Consolidated Fiscal 2001 Performance*

* Percentage changes represent a comparison of the consolidated results posted by Chuo Mitsui in fiscal 2000 and Mitsui Trust Holdings in fiscal 2001.

As of March 31, 2002, the balance of deposits was ¥7,742.4 billion, down 1.5%, and trust assets stood at ¥38.0 trillion, down 12.3%.

Loans and bills discounted in the banking account fell 3.7%, to ¥7,416.0 billion, while loans and bills discounted in the trust account dropped 20.0%, to ¥2,592.9 billion, as of the fiscal year-end.

Investment securities in the banking account decreased 19.3%, to ¥3,436.9 billion, while securities in the trust account slipped 2.8%, to ¥23.0 trillion.

Total assets settled at ¥13.3 trillion, down 3.7%. Total shareholders' equity amounted to ¥496.1 billion, for net assets per share of ¥79.27.

On the profit-and-loss front, total income amounted to ¥540.9 billion, down 17.7%, and total expenses reached ¥958.0 billion, up 56.7%. Mitsui Trust Holdings therefore showed a loss before income taxes and minority interests of ¥417.1 billion and a net loss of ¥277.9 billion. Net loss per share was ¥350.60.

The primary causes of these huge losses stem from Chuo Mitsui's efforts to reinforce its financial position through accelerated disposal of non-performing assets and the clearing of unrealized losses on cross-held stocks.

The consolidated capital adequacy ratio, calculated according to domestic criteria, edged down to 10.59%.

Segment Information by Business Type

The trust-banking business generated total income of ¥466.6 billion and total expenses of ¥819.2 billion, leading to recurring loss of ¥352.6 billion. Other finance-related operations produced ordinary income of ¥73.7 billion and ordinary expenses of ¥50.1 billion, for recurring profit of ¥23.6 billion.

Cash Flows

Net cash provided by operating activities amounted to ¥531.8 billion. Net cash provided by investing activities reached ¥512.0 billion. Net cash provided by financing activities came to ¥40.6 billion.

Effect of exchange rate changes on cash and cash equivalents was ¥351 million, and cash and cash equivalents of previously consolidated subsidiaries at the beginning of the year was minus ¥7.4 billion.

As a result, cash and cash equivalents at the end of the year stood at ¥1,250.7 billion.

Non-Consolidated Fiscal 2001 Performance

Total assets amounted to ¥884.3 billion, chiefly due to the inclusion of investments in subsidiaries' stocks, bonds and loans. Net assets per share came to ¥106.46, based on total shareholders' equity of ¥519.4 billion.

On the profit-and-loss front, recurring profit was ¥22.3 billion, primarily owing to gain on sales of securities. Net income was ¥15.9 billion, for basic net income per share of ¥12.99.

Dividends

Reflecting its public duty as a financial institution, Mitsui Trust Holdings maintains a basic policy of sustaining healthy assets and prudently expanding retained earnings while paying stable dividends to shareholders. Based on this policy and the prevailing economic situation and market environment, management felt it necessary to restrict the flow of funds outside the Company so as to fortify operations, and regrettably, the annual dividend on common stock was reduced to ¥2.50 per share.

Dividends on preferred stock were as follows: ¥40.00 per share for Class I Preferred; ¥14.40 for Class II Preferred; and ¥20.00 for Class III Preferred.

Mitsui Trust Financial Group Risk Management System

Basic Risk Management Policies

Progress in financial liberalization and internationalization, as well as advances in information technology, have accorded financial institutions greater opportunities for business expansion. These opportunities, however, are accompanied by risks that are more diverse and more complex than ever before.

Mitsui Trust Financial Group's position on business growth is cemented by the social responsibility and public mission that is incumbent upon a financial institution. The Group therefore assumes risk only within its strategic objectives and risk-hedging capabilities, based on suitable risk management for each type of risk, and adheres to basic risk management policies to secure appropriate returns on investment and further enhance performance.

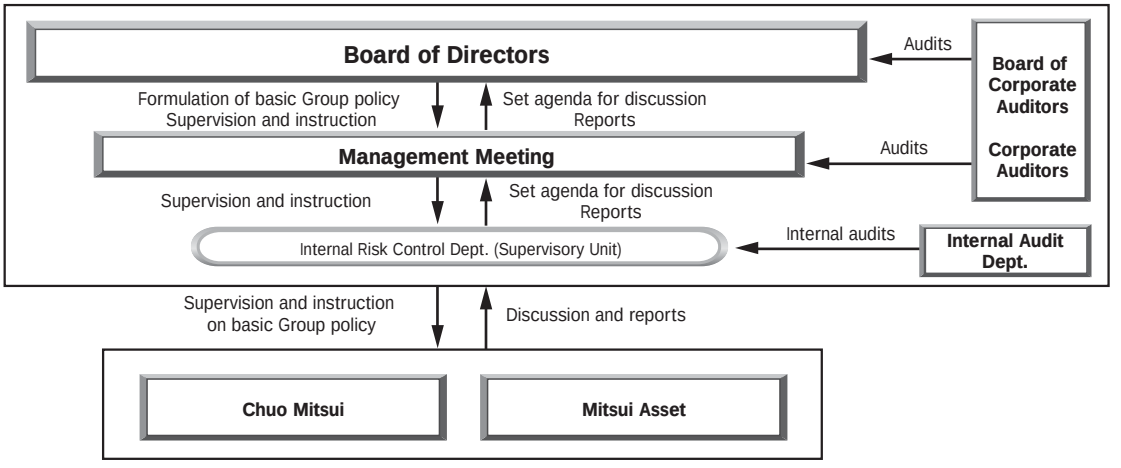
Function of Mitsui Trust Holdings

One of the most vital functions carried out by Mitsui Trust Holdings is its supervision of risk management and internal control for Mitsui Trust Financial Group. The Board of Directors at Mitsui Trust Holdings formulated Rules for Risk Management and established a basic agenda for risk management activities within the Group.

As described in the following sections, the subsidiary trust banks each undertake appropriate risk management geared to their respective risk conditions. The Internal Risk Control Department at Mitsui Trust Holdings acts as the supervisory unit for overall risk management and monitors risk management efforts within the Group, as well as guides subsidiary trust banks in, for example, deriving suitable returns and revising risk management systems.

When required to, Mitsui Trust Holdings instructs subsidiary trust banks to implement changes, based on the results of audits, the status of necessary improvements and other available information.

Outline of Mitsui Trust Holdings' Risk Management and Compliance Structure



Chuo Mitsui Risk Management System

Risk Management Structure

The Board of Directors at Chuo Mitsui drafted Rules for Risk Management, based on the risk management direction outlined by Mitsui Trust Holdings. These rules set out the Bank's fundamental policy on risk management, including the types of risk requiring attention, the techniques applied to hedge risk and the structure and authority for risk control. They also detail the content of specific regulations in each area.

Chuo Mitsui has identified six major risks: credit risk, market risk, liquidity risk, operational risk, system risk and legal risk. The Corporate Risk Management Department supervises all risk management efforts, but individual departments are assigned to each risk category for

strict control of the risks specific to each area. The Bank also seeks to effectively contain other risks, such as reputational risk.

On the organizational front, the Internal Control Executive Committee, which falls under the authority of the Board of Directors, discusses risk management policies prior to implementation and determines risk status. The Asset-Liability Management (ALM) Executive Committee, also responsible to the Board of Directors, works toward a healthier business foundation by pinpointing asset-and-liability status and reviewing investment operations and other issues pertaining to assets and liabilities.

In addition, the Corporate Risk Management Department, which monitors all risk at the Bank, supervises internal controls and risk management activities and serves as the secretariat for the Board of Directors and the Internal Control Executive Committee. This department also engages in ALM-related controls and analysis.

Credit Risk Management

Credit risk is the potential for the value of assets, including off-balance-sheet assets, to shrink or disappear altogether in the event that a borrower's financial conditions deteriorate and thereby burden a financial institution with losses. Chuo Mitsui strives to maintain asset quality and avert the unpredictable development of non-performing assets by strengthening its credit risk management capabilities. The Bank utilizes the following systems and processes.

Basic Policy

Chuo Mitsui drafted Rules for Credit Risk Management for blanket control of the credit risk that influences several credit-related business areas, including loans, market transactions and off-balance-sheet trading. The Bank also designated the Loan Planning Department as the supervisory unit for all credit risk, including that shouldered by consolidated subsidiaries. This department keeps close contact with credit-related departments and consistently works to sustain and further reinforce credit risk capabilities.

Management Techniques

A review of all corporate borrowers is performed using a 13-level credit rating system pegged to self-assessments. The credit ratings thus determined are used to quantify credit risk by internal credit-risk models and evaluations of corporate borrowers.

Taking into account management directions and the need to hold risk within risk-hedging capabilities, the Loan Planning Department sets a value for total credit risk that represents the upper limit for credit risk assumed by all operations at the Bank, and tracks this total on a monthly basis. Rules are also applied to eliminate credit concentration, thereby removing any excess concentration of credit extended to borrowers in specific industries or corporate groups. Credit status is checked each month.

The Loan Planning Department monitors credit risk amounts, examines the status of credit by industry and credit rating and provides management with regular updates on portfolio status.

Seeking to secure an appropriate level of return on investments, Chuo Mitsui introduced the Loan Rating System, which accords each loan a rating that corresponds with the respective degree of inherent risk. This system helps derive higher profit on lending activities.

Strict Transaction Control

Credit supervision departments, which function independently from business promotion departments, carefully monitor and control the credit risk on each transaction under respective departmental authority. A multifaceted perspective is applied that stresses fund application, repayment capability and cash flow, as well as collateral status and corporate client profitability. For major loan assessments, the advisability of lending arrangements is presented to the Credit Appraisal Committee, where each transaction and the primary objectives of the loan are discussed at the executive level.

Mid-Level Controls through Self-Assessment

With regard to securing quality assets, Chuo Mitsui performs a two-stage self-assessment based on Rules for Self-Assessment. In the first stage, staffed branches, for example, conduct their own evaluations, and in the second stage credit supervision departments execute inspections. Self-assessment not only forms the foundation of accurate financial statements but also functions as a mid-level management tool to swiftly pinpoint borrower-specific problems.

When a borrower's credit is in question, the Bank implements strict controls under the guidance of the Credit Management Department, based on Rules for Non-Performing Assets.

Independent Unit Facilitates Double-Check System
The Asset Quality Audit Department is separate from business and accounting departments and independently confirms the status of credit controls, asset assessments, and write-offs and related reserves. This department audits credit risk management conditions, including the credit rating system, and verifies the accuracy of credit risk management activities through, for example, an examination of the process and the results of self-assessments, as well as the appropriateness of write-offs and reserves. Reports are then submitted to the Board of Directors.

Improving Basic Supervisory Capabilities
The processes outlined above allow the Bank to take credit risk management to a higher level. To raise the precision of first-stage assessments, which are undertaken on a daily basis, we regularly put loan officers from staffed branches through graded training. We also organize analytical seminars for credit-related departments to foster insight into the causes of bankruptcies and other primary events that turn loans into problem assets. The results of analyses are applied to lending operations.

Market Risk Management
Market risk is the possibility that the value of assets and liabilities will fluctuate with changing interest rates, foreign exchange rates, the price of marketable securities, and other market factors, and thereby cause losses.

Market Risk Management Structure
Front offices execute market-related transactions, while back offices confirm the content of these transactions and middle offices control market risk. Each office category is independent of the others, creating a cross-check structure. At Chuo Mitsui, the Corporate Risk Management Department functions as a bankwide middle office, monitoring all market risks and providing daily reports to management. This department also works to elevate market risk management skills at the Bank and is responsible for supervising market analysis operations and the preparation of planning proposals.

Management Techniques
The method used by Chuo Mitsui to measure market risk utilizes value at risk (VaR), which assumes the maximum amount exposed to potential loss is 1% of the total. VaR is calculated using the Monte Carlo simulation technique, which is based on an analysis of major historical market data.

At Chuo Mitsui, market risk is contained within a boundary defined by the Bank's risk-hedging capabilities. In addition, the Corporate Risk Management Department controls market risk by ensuring overall risk levels remain within established parameters and reporting conditions to the assigned director on a daily basis.

The measure of market risk is comprehensive, covering foreign exchange, interest rates and other trading business transactions as well as the market risks that impact on crossholdings, bond portfolios and other banking business investments.

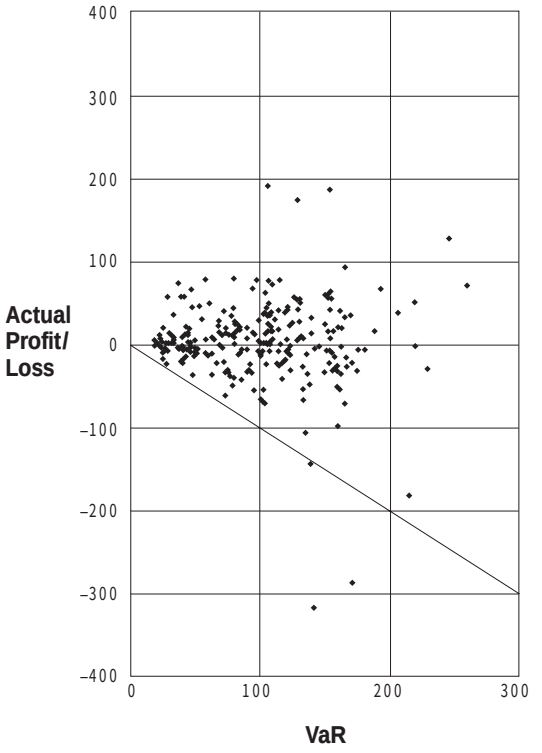
The Bank maintains a structure that averts potential risk before it becomes obvious. Alarm points and loss limits have been set to prevent the expansion of losses following a bad turn in market trading, and the Corporate Risk Management Department tracks profits and losses.

Cementing its position on strict risk-controlling practices, Chuo Mitsui also executes stress tests, which assume radical price swings that have actually occurred in the market over the past 12 years, and uses the results as a guideline for establishing risk limits. As a supplementary measure, the Bank performs back tests, which compare VaR against actual losses, to ascertain the validity of VaR-based risk measurements.

An example of back testing on trading transactions follows.

VaR trading transactions in fiscal 2001 moved within a range of roughly ¥20 million to ¥260 million, and out of 245 business days, daily losses exceeded the VaR on three occasions. The Bank's VaR assumes a loss of 1%, and the results for fiscal 2001 show that the Bank's VaR calculation model is sufficiently accurate to predict market risk.

Comparison of VaR and Actual Profit/Loss
(Millions of yen)



VaR Calculation Assumptions:	Duration:	1 day
	Assumed rate of loss:	1%
	Observation period:	3 years
	Measurement technique:	Monte Carlo simulation
VaR Target:	Trading transactions	
Time Frame:	April 2001–March 2002 (245 business days)	

Liquidity Risk Management

Liquidity risk is twofold. In a cash-flow sense, liquidity risk bears the potential for losses when a financial institution is unable to secure necessary funds, owing to a poor financial position, or when a financial institution is forced to acquire funds at blatantly higher interest rates than usual. In a market sense, liquidity risk may precipitate losses when market turmoil impedes a financial institution's ability to complete transactions, or compels a financial institution to fulfill transactions at prices noticeably more disadvantageous than usual.

On the cash-flow front, Chuo Mitsui establishes guidelines for cash positions and cash gaps and monitors adherence to these standards to control liquidity risk. The Bank also facilitates flexible, bankwide responses through the preparation of contingency plans, which orchestrate measures to be invoked in times of emergency. The Bank further ensures accurate identification of cash-flow risk conditions by allocating to the Corporate Risk Management Department control of the cash-flow risk incurred by the Treasury Department.

On the market front, trading amounts are assigned for each transaction, based on such factors as market scale and the Bank's strategic objectives. The Corporate Risk Management Department monitors compliance conditions to keep amounts within the assigned limits.

ALM Structure and Administration

Diversification and further sophistication of financial products, mirrored by financial liberalization and internationalization, has prompted yearly changes and greater complexity in the balance-sheet composition of financial institutions. The introduction of current-value accounting has heightened the already complicated impact of fluctuating interest rates, foreign exchange rates, stock prices and other influences on profitability and other performance indicators. The new accounting standard underlines the vital importance of ensuring steadily higher returns while controlling risks through appropriate ALM administration.

Chuo Mitsui works to pinpoint and analyze balance-sheet risks through a multifaceted approach that utilizes VaR, basis point value (BPV) and other ALM techniques for both on-balance-sheet and off-balance-sheet transactions, including deposits, marketable securities and derivatives.

The ALM Executive Council meets regularly to discuss financial and economic forecasts, analytical results on risk conditions and other developments related to the composition of assets and liabilities. The Council reviews fund application and procurement plans when necessary and implements controls to ameliorate the risks inherent in market transactions through swaps and other hedging operations.

Operational Risk Management

Operational risk is the danger of losses arising from an accident, management error or dishonest actions by executives or staff. The scope of Chuo Mitsui's operations goes beyond regular banking operations and encompasses a range of businesses that includes real estate business and stock transfer agency services. Consequently, the Operations Administration Department and each operating department are required to ascertain, control and terminate operational risks in each business area.

Chuo Mitsui applies two methods to restrict operational risk. First, the Bank formulates suitable rules to preclude potential risks and ensures compliance of these rules. Second, the Bank clarifies ways to tackle risk—should it emerge—and maintains a system for monitoring and reporting the appearance of risk. The Corporate Risk Management Department is the supervisory unit that regulates bankwide rules.

To make the risk management structure more efficient, Chuo Mitsui promotes changes geared to operational risk conditions in each area of business.

System Risk Management

System risk carries the potential for losses caused by a system failure, such as a computer crash or incorrect operation of electronic equipment, by illegal access to the Bank's computers, and by the destruction or unauthorized disclosure of privileged information. Advances in information technology have made computer systems increasingly indispensable in the provision of high-level services, but this progress brings a certain vulnerability to operations and thus requires financial institutions to be vigilant in anticipating and dispersing such risk.

Chuo Mitsui has established rules and structures in various regulations, including a Security Policy, which outline measures for properly handling and protecting systems and information.

The Bank also maintains a backup center and has formulated various methods to safeguard its systems against breakdowns and interruptions caused by natural disasters. Efforts include storing important data at a secondary location, installing duplicate communication lines and ensuring a constant flow of electricity to the computer center with an on-site power facility. Contingency plans and other precautionary measures are in place to facilitate swift and accurate responses in the event of a catastrophe.

Chuo Mitsui makes some of its financial services available through the Internet and therefore utilizes firewalls and other high-level network technologies, such as encryption, to block unauthorized access to in-house systems from outside.

Legal Risk and Reputational Risk

Legal risk can precipitate losses if the legal aspects of transactions cannot be settled or if compliance is incomplete. Chuo Mitsui assigned the Legal Department as the supervisory unit for managing legal risk and ensuring that laws and other mandatory controls are upheld. Inspections by the Legal Department clarify reporting and processing rules for dealing with complaints and incidents to eliminate legal risk. Furthermore, the Bank works to foster a corporate atmosphere conducive to compliance and undertakes various measures toward this end, including distribution of a compliance manual to directors and regular staff.

Reputational risk is the possibility that unfavorable evaluations will contribute to losses. To mitigate such risk, Chuo Mitsui is reinforcing the transparency of its operations with better investor relations activities, including information meetings and vigorous disclosure documents that update investors with pertinent news.

The Bank has established conduits for two-way communication, at branches counters and through the Customer Service Office, that enable clients to voice grievances and obtain suitable responses. The end result will be enhanced services for clients.

Internal Auditing

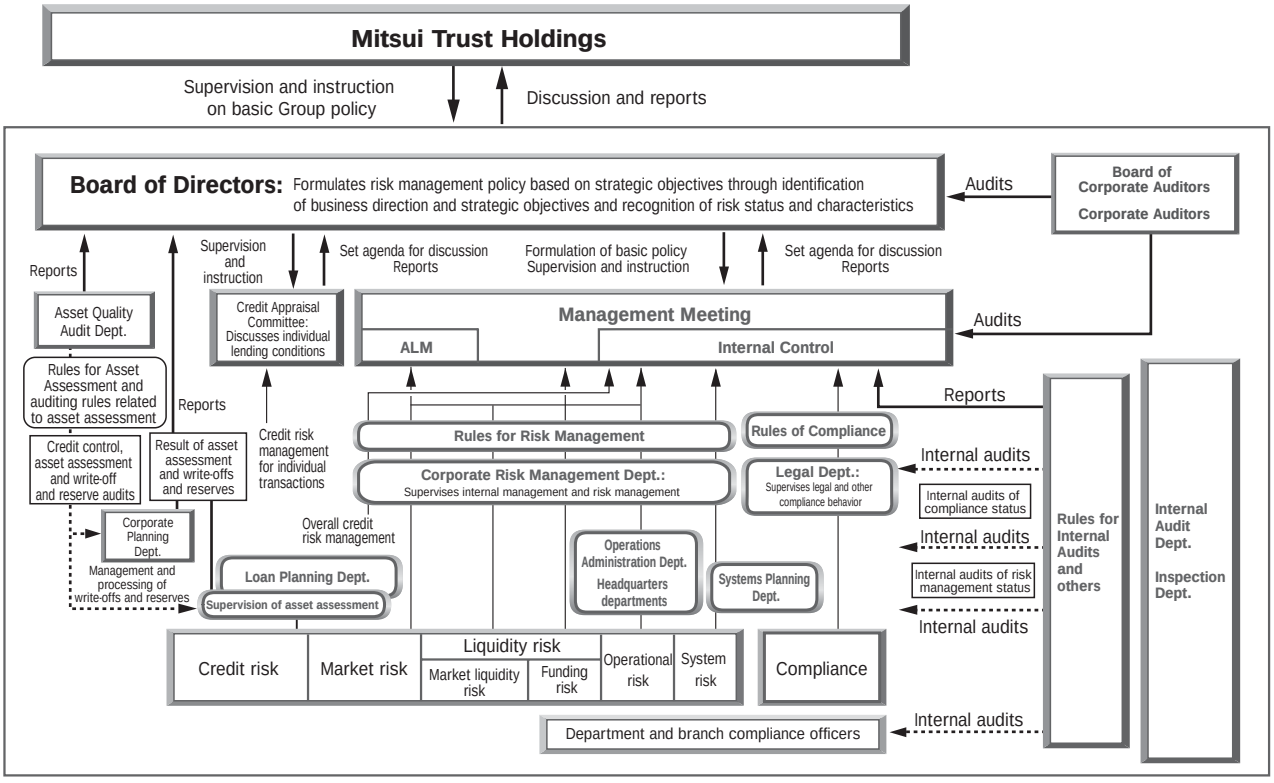
Previously, Chuo Mitsui conducted inspections, primarily status checks on administrative procedures, to confirm the appropriateness of risk management and compliance efforts at the Bank. These inspections alone, however, proved insufficient.

Recognizing the need for internal auditing capabilities that validate the suitability and effectiveness of the internal control structure, the Bank executed a reform of its internal auditing section in October 2001 and established the Internal Audit Department.

Currently, the newly established Internal Audit Department, in connection with the existing Inspection Department, undertakes internal audits of all head office divisions, staffed branches and affiliated companies.

The results of internal audits are reported to the Board of Directors and the Internal Control Executive Council on a regular basis to enable the executive team to determine the status of risk management and ascertain that suitable administration practices prevail at the Bank.

Outline of Chuo Mitsui's Risk Management and Compliance Structure



Mitsui Asset Risk Management System

Risk Management Structure

Mitsui Asset is a trust bank specializing in pension and securities trust businesses. Guided by the risk management direction outlined by Mitsui Trust Holdings, Mitsui Asset follows a basic policy that emphasizes appropriate control of risk and suitable returns commensurate with inherent risk.

Mitsui Asset's core operations are trust asset management and administration as well as pension and securities trust businesses. It is duly aware of its obligations and responsibilities as a trustee and executes risk management reflecting the size and characteristics of each risk.

Rules for Risk Management, drafted by the Board of Directors, establishes Mitsui Asset's fundamental policy on risk management, including the types of risk requiring attention, the techniques applied to hedge risk, and control and administration structures, and detail the content of specific regulations in each area.

On the organizational front, the Executive Committee, which falls under the authority of the Board of Directors, discusses risk management policies prior to implementation, determines the status of all risks and works toward a healthier business foundation.

The Corporate Risk Management Department supervises all risk management efforts, but individual departments are assigned to each risk category for strict control of the risks specific to each area.

Risk Management Status

Mitsui Asset is working to establish and perfect a risk management structure that conforms to the risk management structure of Chuo Mitsui while reflecting the characteristics of its own operations, with a focus on operational risk, system risk and legal risk.

In regard to credit risk, market risk and liquidity risk, Mitsui Asset's policy is, in principle, to refrain from lending and thereby minimize its risk-taking position. The extent of risk management activities therefore mirrors this limited exposure.

Mitsui Asset seeks to effectively contain other risks, such as reputational risk.

The burden of credit risk, market risk and liquidity risk management for its core trust businesses essentially lies with the beneficiaries. Mitsui Asset takes the view, however, that a trustee should accept a certain degree of responsibility and therefore carries out adequate risk management.

Trust operations are divided broadly into two categories: designated trusts, which are trusts for which Mitsui Asset, in its capacity as trustee, holds discretionary rights for the management of assets, and specified trusts, for which it does not hold such rights. Risk management is conducted for each category.

For designated trusts, Mitsui Asset manages entrusted funds in accordance with contract conditions, such as designated investment targets and preferred asset composition. Mitsui Asset also sets clear internal standards for exercising discretionary rights granted by clients and manages respective assets within these established parameters.

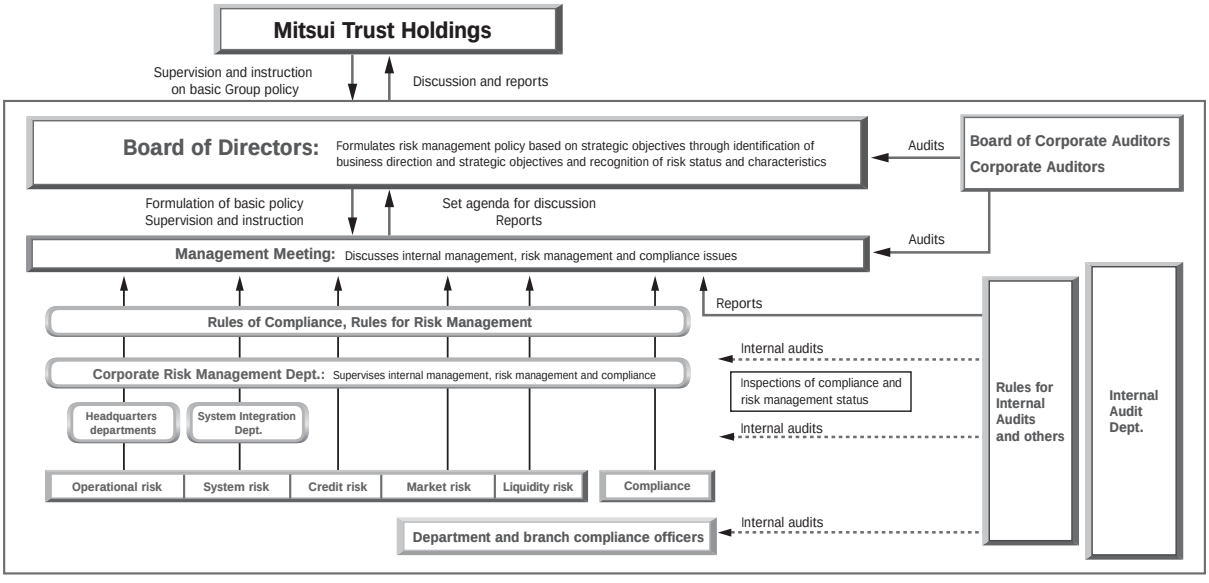
For specified trusts, Mitsui Asset conducts a trustee examination, similar to that for designated trusts, at the time a new contract is formed. The compatibility of the request to its capabilities is confirmed and procedural strategy is checked.

Auditing and Inspection

The Corporate Risk Management Department at Mitsui Asset supervises compliance and risk management, but the Internal Audit Department executes internal audits to determine the status of compliance and risk management systems and validates the suitability and effectiveness of the overall internal control structure. The Internal Audit Department audits operations, inspects administrative processes and strives to set up efficient auditing systems that take the type and degree of risk into account.

Mitsui Asset executes accounting audits based on the Commercial Code through auditing corporations, as well as statement audits on pension investment fund trusts through external auditing corporations. Mitsui Asset undergoes SAS 70 audits, acquires ISO 9002 certification and submits to inspections on the status of conformity to the global investment performance standard (IPS). Through these efforts, it shows a resolute commitment to upholding strict internal controls that translates into greater client confidence.

Outline of Mitsui Asset's Risk Management and Compliance Structure



Compliance

Mitsui Trust Financial Group Perspective

Trust banks accept funds from people and organizations and in turn facilitate a steady flow of funds for various financial purposes that ultimately benefit the economy. Striving to demonstrate their trust function in satisfying diverse market needs, trust banks shoulder a social responsibility and a public mission to contribute to the development of the national economy.

Unfolding liberalization, deregulation and other finance-related developments, however, require all financial institutions to uphold the principle of self-responsibility in conducting business. Consequently, efforts to comply with prevailing laws and ordinances and establish a structure that ensures compliance have assumed paramount importance.

Against this backdrop, financial institutions are expected to operate as private corporations, with their social obligations evolving onto a higher plane. Fulfillment of this dual designation is a vital prerequisite in securing the unwavering trust of clients and society as a whole.

Sound and appropriate management is indispensable in the effort to sustain and further elevate the level of trust accorded to us by the market. Such management status is grounded in the principle of self-responsibility, which demands rigorous self-discipline. From this perspective, compliance is one of the most important management issues at Mitsui Trust Financial Group and one that the Group will continue to uphold.

Strictly speaking, compliance means rigid observance of laws and ordinances, but a broader perspective embraces social criteria as well. For the Group, trust is its biggest asset. Therefore, achieving compliance is a foregone conclusion, and executives and employees alike must conscientiously incorporate compliance into their daily routines.

Function of Mitsui Trust Holdings

The Internal Risk Control Department is the supervisory unit for compliance at Mitsui Trust Holdings. The Department promotes various measures to ascertain compliance status for Mitsui Trust Financial Group. These measures include Rules of Compliance, which establish a basic policy on business ethics and provide guidelines governing the conduct of employees, Rules for Compliance Management, which set criteria related to compliance conditions at the Bank, and the Compliance Manual, a detailed handbook.

Compliance at Chuo Mitsui

Supervision of compliance status at Chuo Mitsui is the responsibility of the Legal Department, which promotes measures to reinforce the compliance structure based on Group policy. For example, the Bank encourages all employees, including executives, to read and fully understand the Rules of Compliance and the Compliance Manual, which is updated as necessary.

Chuo Mitsui also outlines bankwide schemes under its Compliance Program, a concrete action agenda that is complemented by the independently designed plans of staffed branches and head office departments to ensure the highest level of compliance.

Compliance at Mitsui Asset

The Corporate Risk Management Department has been designated as the supervisory unit for compliance at Mitsui Asset. In line with Group policy, compliance methods mirror those described above for Chuo Mitsui, but the measures used to improve compliance status are fine tuned to the characteristics of the Mitsui Asset's own focus on pension and securities trust businesses.

Trust Account and Banking Account

Trust banks keep two types of account: the banking account, which is the institution's own; and the trust account, which is the account of beneficiaries. Trust banks have a number of trust accounts, reflecting the fact that they must separately administer the assets of each trust contract. In principle, details of individual accounts are disclosed only to trustors or beneficiaries. Nevertheless, the total balances of money and pension trusts are recorded in the trust account's aggregate balance sheet. The main assets and liabilities of the trust account with principal guarantee agreement are also disclosed.

Although trust assets nominally belong to trust banks, in fact they belong to the beneficiaries. The institutions therefore receive trust fees for managing these accounts. After deductions for fees and expenses, the profits generated with these accounts all become trust assets.

Trust fees represent one source of income in the banking account. In other words, the banking account income statement reflects both earnings from banking operations and from trust operations.

The Concept of Net Operating Profit *(Gyomu Juneki)*

To calculate core profits—excluding items outside core operations, such as stock earnings and losses and write-offs of non-performing assets—we calculate the net operating profit by selecting only those items that express the earnings from core operations from within the income statement.

Net operating profit is calculated by subtracting the general and administrative expenses and the transfer to the general reserve for possible loan losses from gross operating profit. Gross operating profit comprises:

- Net interest income (such as from deposits, loans and marketable securities);
- Net fees and commissions (trust fees, and fees and commissions);
- Net trading gains (earnings from trading purpose transactions); and
- Net other operating income (such as earnings from foreign exchange and bond trading).

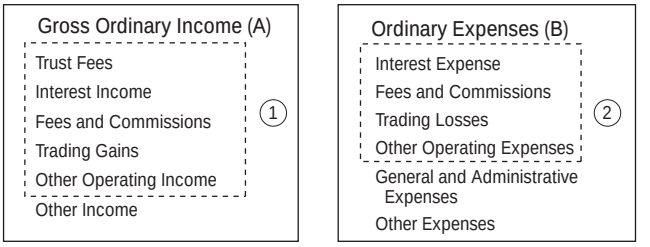
Net Operating Profit at Trust Banks

In addition to net operating profit, trust banks disclose net operating profit before trust account write-offs. With trust banks, the net operating profit calculated according to the formula mentioned above does not adequately reflect the profitability of core operations. Trust fees, which are part of business profit, are calculated after subtracting loan write-offs in the trust account. Therefore, net operating profit is smaller than a trust bank's actual profitability in core operations.

To adjust for this difference and more accurately reflect the profitability of core operations, trust banks calculate net operating profit before trust account write-offs. This allows a comparison with other banks according to net operating profit.

The effective net operating profit is calculated by adding back the transfer to general reserve for possible loan losses from net operating profit before trust account write-offs. The purpose of this calculation is to show the trend of a bank's earning power by eliminating all credit costs including transfers to general reserves.

•The Relationship between Ordinary Income and Net Operating Profit



Ordinary Income
This is calculated by deducting ordinary expenses (B) from gross ordinary income (A).
Gross Operating Profit
The amount remaining after subtracting the highlighted areas in box ② from those in box ① is nearly equal to gross operating profit.
Net Operating Profit
This results from subtracting general and administrative expenses and the transfer to general reserve for possible loan losses from gross operating profit. The transfer to the general reserve for possible loan losses is part of other expenses.

Note: General and administrative expenses in the calculation of ordinary income include retirement payments and transfers and reimbursements to retirement reserves. The general and administrative expenses in the calculation of net operating profit only include the transfer to retirement reserves.

•Sample Calculation of Net Operating Profit before Trust Account Write-Offs