Risk Management

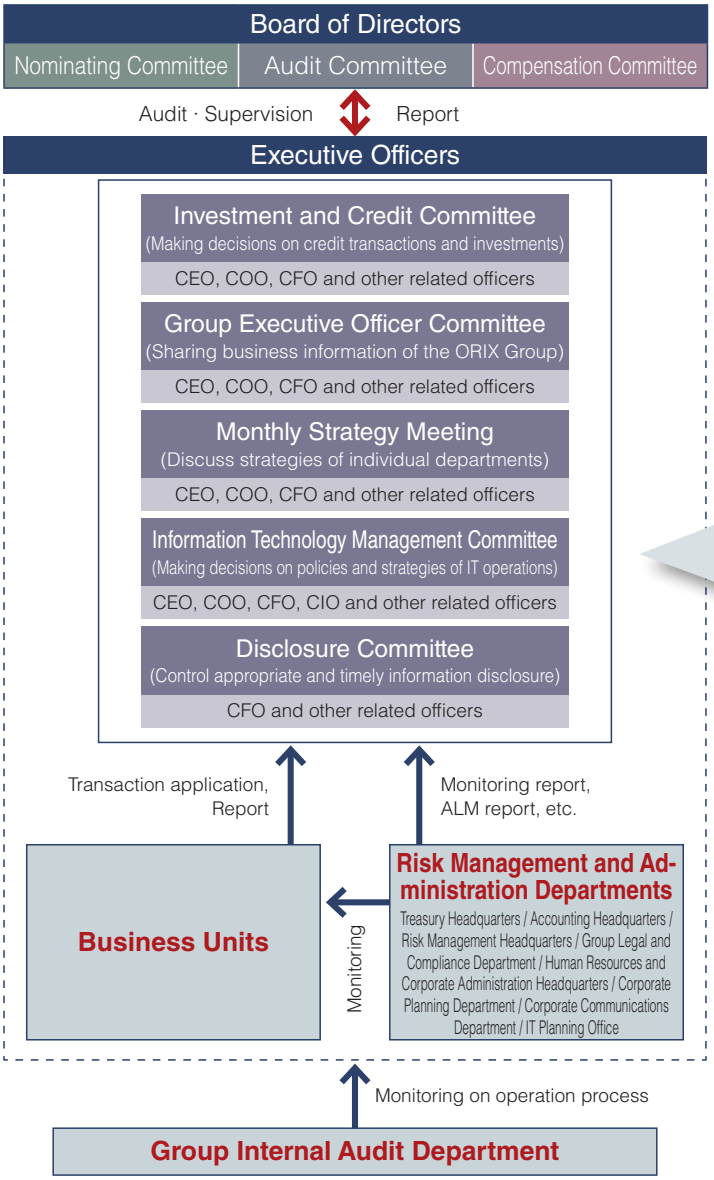
Risk Control

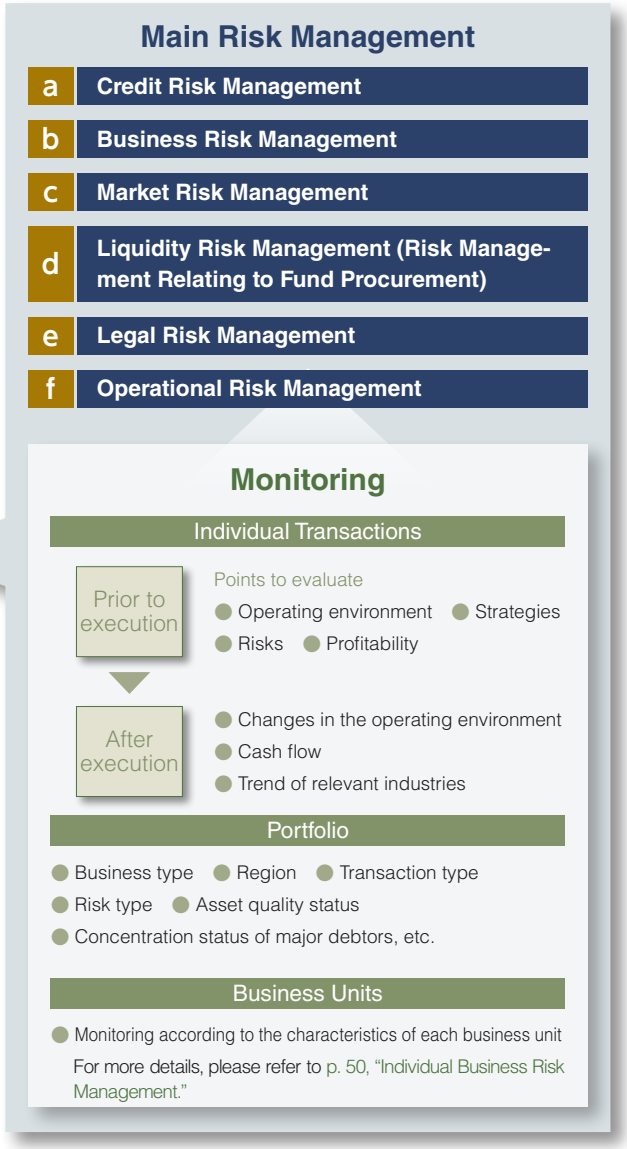
The ORIX Group allocates management resources by taking into account Group-wide risk preference based on management strategies and the strategy of individual business units. Our Board of Directors and executive officers evaluate the performance and profitability of each business unit, and along with the CFO as the person responsible for overall risk management, take the responsive measures they deem necessary. This process makes it possible for us to both control the balance sheet and allocate more management resources to business units having greater growth potential.

Risk Management System

The ORIX Group monitors its business both on an individual transaction and total portfolio basis, as well as by business unit. Business units and risk management and administration departments cooperate to analyze and manage risk from various perspectives. The monitoring results are regularly reported to the Board of Directors, and the relevant executive officers and who after receiving these reports evaluate the risk and take the measures deemed appropriate.

As of July 1, 2013





Main Risk Management

The ORIX Group recognizes that credit risk, business risk, market risk, liquidity risk (risk relating to fund procurement), legal risk and operational risk are the main risks facing us and manages each of these risks according to its own characteristics.

a Credit Risk Management

We define credit risk as uncertainty regarding future recovery of investments caused by the fluctuation in the cash flow of debtors and investees.

To manage credit risk, we analyze each individual credit transaction before and after execution. We focus on the adequacy of collateral and guarantees, the liquidation of debt and the concentration of debtors and their business types.

We conduct a comprehensive customer credit evaluation based on the customer's financial position, projected cash flow, underlying security interests, profitability and other factors. Profitability is based on, among other things, the spread calculated from investment yield, default rates and underlying security interests, which helps us to evaluate risk quantitatively.

Moreover, an analysis of our total portfolio, as well as measures to establish appropriate credit limits, allows us to control exposure to markets with potentially high risks.

We recognize problem assets to include credit extended to debtors who have petitioned for bankruptcy or civil rehabilitation, or other insolvency proceedings; whose bank transactions are suspended, bills are dishonored, debts are not collected for three months or more or businesses have deteriorated; or who are involved in fraud. The relevant business units, in cooperation with the Risk Management Headquarters, take steps to secure collateral or other guarantees and to begin the collection process. The accumulated collection know-how from sending an initial reminder to actively seizing collateral is consolidated at the Risk Management Headquarters and is reflected in our evaluation criteria for individual credit transactions and portfolio analysis.

b Business Risk Management

We define business risk as uncertainties related to new business areas, potential obsolescence of the products or services we offer or a decline in their quality, and variability in market prices for products of the types we offer.

We monitor business plans and operations using scenario analyses and stress tests for business risk, and the cost of withdrawal from a business is also subject to evaluation and verification at those times.

In addition to monitoring the quality of our products and services, in response to changes in the business environment and evolving customer needs, we review the content of our lineup of products and services and endeavor to maintain or improve their quality.

A principal risk relating to operating leases is fluctuation in the residual value of the leased properties. To control fluctuation in residual value, we monitor our inventories of leased properties, market environments and the overall business environment. We generally limit our operating leases to leased properties with high versatility that are comparatively easy to re-lease, and evaluate the sale of such properties depending on changes in market conditions.

We endeavor to reduce the risk related to fluctuation in market prices for real estate by emphasizing cash flows in our investment strategy.

c Market Risk Management

We define market risk as the risk of changes in the fair value of assets and liabilities caused by changes in market variables, such as interest rates, exchange rates and stock prices.

We establish Group-wide asset liability management ("ALM") rules, and we endeavor to manage the overall amount of market risk within a fixed range by comprehensively verifying the volatility of fair value for our assets and liabilities and the impact thereof on profit and loss using both quantitative and qualitative analysis.

Interest rate risk is evaluated based on quantitative analysis methods such as sensitivity analysis, scenario analysis and stress tests. Comprehensive evaluations are also made using such quantitative analysis and qualitative analysis of the condition of assets and liabilities and the procurement environment. These analysis methods are reviewed, as required, depending on the situation.

We generally manage exchange rate risk by using foreign currency loans, foreign exchange contracts, currency swaps and other instruments to hedge exchange rate volatility in our business transactions in foreign currencies and overseas investments.

When we use derivative transactions as a means of hedging, we manage counterparty credit risk and other risks involved in hedging derivative transactions in accordance with internal rules on derivative transaction management.

For assets under management of the banking business, the life insurance business and our U.S. operations, while regularly monitoring monetary policies, macroeconomic indicators and securities and financial market trends, we manage our asset portfolios by analyzing on a daily basis individual security price movements and gains and losses. Market volatility is managed according to guidelines that include fixed loss amounts and decreases in position. Our risk management departments monitor our compliance with the guidelines.

d Liquidity Risk Management (Risk Management Relating to Fund Procurement)

We define liquidity risk as the risk that we will be unable to obtain the required funds, or that we will be forced to procure funds at an unusually high rate of interest due to market turmoil, deterioration in the financial condition of the ORIX Group or other reasons.

To reduce liquidity risk, we diversify fund procurement methods and sources and monitor liquidity on hand. To manage liquidity on hand, we project future cash flows and evaluate liquidity risk in hypothetical stress scenarios. We take necessary measures accordingly so that business may continue undisturbed in the event of environmental changes.

Liquidity risk management for the ORIX Group includes not only monitoring the effect on the business of the Group as a whole but also the effect on the business of each subsidiary by ascertaining liquidity risk in each subsidiary and in every country in which ORIX operates and taking appropriate steps such as parent-to-subsidiary lending.

ORIX Bank Corporation ("ORIX Bank") and ORIX Life Insurance Corporation ("ORIX Life Insurance") are engaged in retail financial activities such as accepting deposits and insurance underwriting and are regulated by Japanese financial authorities. Therefore, they are required to manage liquidity risk independently from other ORIX Group companies based on internal regulations formulated according to the relevant regulations.

e Legal Risk Management

We define legal risk as the risk of legal responsibility or legal disadvantage arising due to noncompliance with applicable regulations in any business or corporate management.

To avoid, prevent and mitigate transactional legal risk in Japan, we generally require that the Group Legal and Compliance Department and the Risk Management Headquarters be involved in transactions. In addition to establishing internal rules necessary to observe applicable laws, we implement necessary steps to

ensure that we are, and continue to be, in compliance with revisions to laws as they take effect.

For transactional agreements, we have established an approval process involving the Group Legal and Compliance Department and the Risk Management Headquarters, in accordance with our prescribed internal rules. In addition, depending on the size and importance of a given transaction, we might also utilize the expertise of outside lawyers. To ensure that proper legal procedures are followed in connection with legal disputes and litigation, we require that the Group Legal and Compliance Department and the Risk Management Headquarters be involved in the management of such disputes and litigation, including lawsuits that have been, or are expected to be, brought against us and lawsuits that we bring, or expect to bring, against third parties.

To prevent the violation of intellectual property rights and to quickly take necessary measures, monitoring activities are conducted if and when violations are discovered.

Overseas, each Group company works to avoid, prevent and mitigate risks by utilizing in-house legal functions and, when necessary, by engaging outside lawyers and other advisers.

f Operational Risk Management

We define operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.

The Group Internal Audit Department monitors the effectiveness, efficiency and compliance with applicable rules and regulations for our various operations, as well as the status of improvements and compliance with our internal regulations, based on an annual internal audit plan that focuses on material risks. In addition, each department conducts monitoring activities according to a self-examination system.

The Group Legal and Compliance Department has produced a compliance manual and distributed it to all executives and employees. The department also plans and executes an Annual Compliance Plan for each Group company based on Group Compliance Fiscal Year Policy.

ORIX Computer Systems Corporation aims to reduce operational risk through the maintenance and operational administration of internal systems.

We have established internal rules to manage risks associated with natural disasters, designed to protect management resources and minimize losses, while giving priority to the safety of our executives and employees. The Human Resources and Corporate Administration Headquarters supervises activities after the occurrence of a disaster in Japan, whereas the Global Business and Alternative Investment Headquarters supervises activities in the event of disaster overseas. In addition, we distribute natural disaster manuals to all executives and employees in Japan and carry out disaster drills on an ongoing basis.

Individual Business Risk Management

The ORIX Group has a broadly dispersed business portfolio, including financial service operations. We perform complete and transparent monitoring and risk management according to the characteristics of each business operation.

Corporate Financial Services Segment

Credit risk is the main risk of the Corporate Financial Services segment.

After individual transactions have been executed, the Corporate Financial Services segment regularly monitors performance and collateral, as well as collection from customers whose balances exceed specified levels. The Risk Management Headquarters regularly evaluates customers with large credit balances.

We analyze the current condition and outlook for specific business types and industries and analyze the potential impact on customers while making decisions about future transactions in that specific business type or industry.

For problem assets, particularly in transactions collateralized by real estate, we take various measures such as capitalizing on our network of real estate–related departments to sell properties or introduce tenants.

Maintenance Leasing Segment

Business risk and credit risk are the main risks of the Maintenance Leasing segment.

To manage the risk of changes in market values of property under operating leases, we continuously monitor market environments and fluctuation in the resale value of leased property and adjust residual value estimates of leased property accordingly.

Cost fluctuation (prime cost) is the main risk of providing various services. In response to this, we analyze initial preconditions and performance, monitor future forecasts and control costs at an appropriate level.

In addition to managing the risk that the quality of our services might fall short of customer expectations due to changes in the operating environment or changes and diversification of client needs, we monitor our service quality quantitatively and qualitatively and continuously strive to improve our services and make improvements in line with the operating environment.

We also conduct credit examinations against individual transactions before and after execution to manage credit risk.

Real Estate Segment

In the Real Estate segment, the main risk for business involving real estate development, possession and operation is business risk, and the main risks for business involving real estate finance are market risk and credit risk.

With respect to real estate investment, we monitor investment strategies and schedules and in the case of a major divergence from the initial forecast, we reevaluate our strategy. We invest mainly in small properties and diversify risk by investing in large properties through joint ventures with partners.

For condominiums, we monitor development and sales schedules, unit sales progress and rates of return. For development and leasing properties, we monitor development and retention schedules and NOI yield. We capitalize on the Group's network in order to improve occupancy rates and promote sales.

Our operation business monitors occupancy rates and rates of return and concentrates on creating manuals and educating employees.

In our real estate finance business, regarding nonrecourse loans, we carefully examine the loan-to-value ratio ("LTV"), the debt service coverage ratio ("DSCR") and other contractual terms and conditions such as the equity provided by other companies, the interest reserve and guarantees to control the relevant risks.

In addition, depending on the circumstances, we may foreclose on collateral and hold and operate it ourselves, thereby taking on business risk.

Investment and Operation Segment

Credit risk, business risk and market risk are the main risks of the Investment and Operation segment.

When making investment decisions in the principal investment business, we do a credit evaluation, analyzing the investee's credit risk and assessing its cash flow. In addition, we perform a multifaceted evaluation on the characteristics of the operation and investment scheme, in which administrative departments such as the accounting and legal departments are also involved. Credit risk is emphasized for the companies for which we are raising corporate value due to the focus on cash flow. We also monitor market risk as time for collection nears, measuring corporate value by referencing the corporate values of similar business types. The frequency of monitoring could increase based on changes in the business environment, and we simultaneously verify the adequacy of investment scenarios and take necessary action. Furthermore, for investments that have a significant impact on the profitability of the ORIX Group, we work to strengthen management through such measures as the dispatch of management personnel.

In the servicer business, we seek to reduce credit and operational risks by conducting periodic internal auditing and monitoring and by implementing a business operation based on work procedures in accordance with applicable guidance from regulatory authorities.

In the environment and energy-related businesses, for renewable energy, energy conservation, and resource and waste processing operations, we endeavor to minimize business risk by deploying appropriate equipment and technology, forming alliances with expert operators and arranging our business structure to allow for changes in the business environment and the business content.

Retail Segment

The main risk in the life insurance business is business risk, in particular, the risk associated with underwriting insurance contracts.

When underwriting insurance contracts, while implementing strict assessment standards, cultivating employees with expert knowledge and hiring sufficient staff, ORIX Life Insurance also checks the status of other insurance contracts and takes rigorous measures to prevent the underwriting of fraudulent contracts. In addition, ORIX Life Insurance educates and instructs representative branch staff and agents to enhance compliance with applicable laws and regulations regarding the privacy of personal information, as well as insurance sales practices, and regularly conducts checks related to these measures.

Credit risk is the main risk of the housing loan business, the corporate lending business and the card loan business.

Regarding housing loans (for the purchase of condominiums and apartments for investment purposes), we conduct screenings, which consist of a comprehensive evaluation including not only the client's ability to repay but also the cash flows that can be derived from the property and its collateral value. Regarding corporate lending, we make a decision based on an investigation of the client's performance, business plan, the purpose of the loan, the source of repayment and industry trends. We also reduce risks by diversifying the business types and products of our portfolio. The card loan business uses our own scoring system incorporating a credit model. We set interest rates and credit limits in line with each customer's credit risk profile, after evaluating customer creditworthiness based on an analysis of customer attributes or payment history, as well as other factors that might affect the ability of the borrower to repay. Also, we undertake subsequent credit evaluations at regular intervals to monitor changes in the customer's financial condition.

Overseas Business Segment

In the Overseas Business segment, credit risk is the main risk of the leasing and loan businesses operated by local subsidiaries mainly in Asia. Individual transactions in this segment are conducted in a manner similar to those in the domestic business segments. The Risk Management Headquarters monitors the portfolio according to country risk. Information regarding the portfolios of the respective local subsidiaries, the performance of major clients, the condition of problem assets and the clients of particular concern is shared internally.

Risk management in the principal investment business and the automobile business, which are mainly in Asia, is conducted in a similar manner to that in the domestic business segments. In addition, in the ship- and aircraft-related business, we monitor market environments and the overall business environment for business risk. We generally limit our operating leases to ships and aircraft with high versatility that are comparatively easy to re-lease and evaluate sales depending on changes in market conditions.

Credit risk and market risk are the main risks for the investment and finance business such as corporate loans and securities investment in the United States. Regarding credit risk, at the time of origination we assign an internal credit rating to each investment or loan taking into consideration the credit status and the collateral status and continually monitor the credit status. Regarding market risk, we monitor market values while referring to credit risk information and manage risk by pursuing early sales as appropriate to secure profits or minimize losses.

Operational risk is the main risk for the loan servicing business in the United States. We conduct our operations based on the designated operating procedures set forth by public financial institutions such as Fannie Mae and the Federal Housing Administration, and monitor and manage service quality through internal auditing.

Operational risk and business risk are the main risks for the advisory business and the asset management business in the United States. In the advisory business, we maintain and ensure quality and operational procedures that meet the operating standards set forth by authorities through an internal quality control committee and other oversight. In the asset management business, to manage operational risk we have established an internal compliance system and manage our operations to abide by established compliance standards as an SEC-registered company.

Regarding business risk in the advisory business and the asset management business, in addition to monitoring to maintain and ensure satisfactory quality levels, in response to changes in the business environment and evolving customer needs, we review the content of our products and services to constantly maintain and improve quality.