Special Feature I.

Review of the Previous Medium-term Management Plan (FY 2000-2002)

- We must reflect on how the assumptions in our previous medium-term management plan differed from actual business conditions in order to objectively analyze where our efforts at corporate self-improvement fell short. In doing so, we will be able to determine the next steps we should take to move forward.
- In our retail securities business, further reforms are needed, especially in our marketing structure. This is because we have not been able to tap into the huge latent demand that exists among personal financial assets.
- In our wholesale securities business, trading gains showed some improvement, but earning levels are still low. This, however, is not only a problem with our wholesale business. We are aware that cooperation across the Group is absolutely necessary to strengthen our product development capabilities, which in turn will lead to higher trading gains. On the other hand, our investment banking operations are experiencing a steady increase in benefits from our collaboration with Sumitomo Mitsui Banking Corporation.
- In the asset management business, low interest rates resulted in sizeable cancellations of bond investment trusts while the lackluster stock market led to a sharp decline in sales of Japanese equity-linked investment trusts. In addition, zero interest rates have caused a continuing decline in management trust fees. Similar to the problems besetting trading activities, an increase in product development capabilities and better interaction within the Daiwa Securities Group are issues that must be addressed before the asset management business can recover.
- Our financial base has improved, but more progress is needed. We must also exercise greater control over the investments that we are making in our employees and computer systems, to the extent it does not sacrifice our growth potential.

Assessing the Impact of the Business Climate

Outline of the Business Climate over the Last Three Years

Believing that the high-tech industry would play a leading role in the global economy on the back of the IT revolution, we set our previous medium-term management plan in March 2000 based on the following business scenarios: (1) a continued expansion of the global economy with the U.S. as the driving force of that expansion; (2) growth in Japan's economy led by a recovery in corporate earnings stemming from deregulation and an expansion of exports; and (3) a huge rebound in the stock market in response to the aforementioned scenarios, which would lead to the dramatic shift of expanding personal financial assets into the securities market. (We expected that the large volume of fixed-rate postal savings accounts reaching maturity, the phasing out of blanket deposit insurance on bank accounts and the introduction of a defined-contribution corporate pension system would all contribute to accelerating the aforementioned shift.) Unfortunately, the reality over the past three years was radically different from what we had expected in our scenario.

There was once considerable talk of how the "new economy" had helped the U.S. achieve steady growth in the 1990s. At the start of the 21st century, however, the tone changed and economic performance in the U.S. began to stumble, due in part to excess investment in the high-tech industry and also due to the after-effects of the September 11 terrorist attacks. As a result, the New York Dow Jones Index, after peaking at 11,722 in January 2000, showed little movement over the next year and a half, before eventually plunging to almost 7,200 in October 2002.

Meanwhile, Japan's economy was digging itself a deeper hole. While the government continues to tighten its budget and put a priority on fiscal reconstruction, not as much progress has been made with structural reform and deregulation as we expected. Also, the conversion to domestic demand-led economic growth has not been realized and faltering exports have had a direct negative impact on the Japanese economy.

Goals We Did Not Meet

Unfortunately, we fell far short of the goals set in our previous medium-term management plan up through FY 2002. For example, while we set a consolidated ROE target of 15% for FY 2002, the actual figure we attained was –1.1%.

Daiwa Securities Co. Ltd. (Daiwa Securities) and Daiwa Securities SMBC Co., Ltd (Daiwa Securities SMBC), the two securities-related arms in our Group, are rated BBB, due to stagnant earnings and a harsher business environment. This was in contrast to our goal of obtaining a better-than-single-A rating.

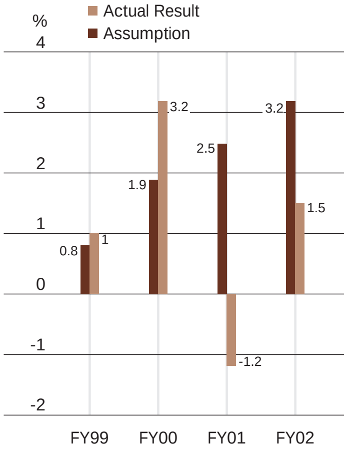
Reviewing External Factors to Determine How We Could Have Done Better

By assessing the actual business environment against the assumptions made at the time the medium-term management plan was set, we do not mean to blame the failure to achieve our goals on external factors. On the contrary, our purpose is to analyze what we did well and what we did not do very well regardless of the external environmental factors. In doing so, we can continue improving on our successes, amend our errors and change course where necessary.

GDP : Growth Rates Were Significantly Lower Than our Assumptions

There were three assumptions we made about the business environment in our previous medium-term management plan. These were forecasts for (1) GDP growth, (2) TOPIX and (3) the amount of personal financial assets. Regarding GDP, we assumed that real GDP would grow by an annual average of 2.5% while nominal GDP would increase an average of 2.7% over the three-year period. These GDP growth assumptions were based on our expectations of an end to deflation and positive economic growth. The actual GDP results, however, were totally at odds with this outlook. Real GDP showed nearly flat growth, increasing only an average of 1.2% over the three years, while nominal GDP actually shrank an average of 0.7%.

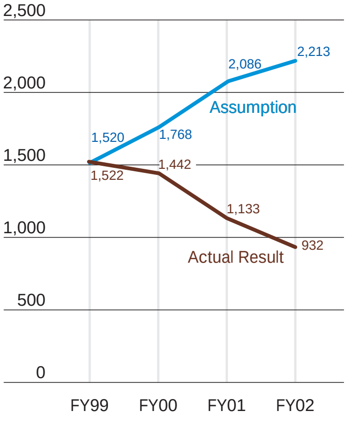
Assumptions vs. Actual Results of the GDP



TOPIX : Our Assumption Was an Increase of 46%, but the Reality Was a Decline of 39%

With respect to the stock market, there was a much greater difference between our assumptions and the actual results than with the GDP figure. While we assumed that the TOPIX index(annual average) would rise 46% over three years, it instead declined by 39%. If there is any truth in the sayings “share prices are leading indicators of the real economy” and “the market is always right,” the fact that the difference between our stock market performance assumption and the actual result was larger than that for GDP suggests an uncertain outlook for the economy. The reason why we did not formulate our new medium-term management plan assuming recoveries in the domestic economy and the stock market is because we have analyzed the situation and learned our lesson.

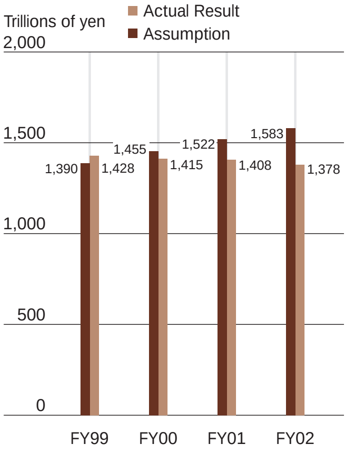
Assumptions vs. Actual Results of the TOPIX index (annual average)



Analyzing Personal Financial Assets

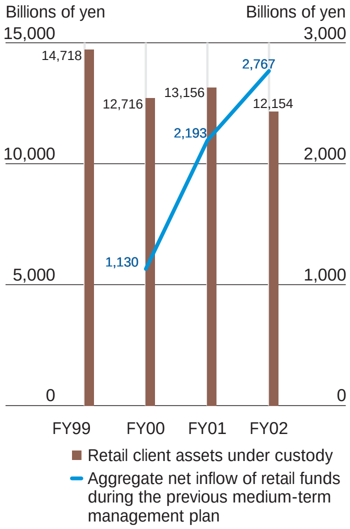
On the other hand, our assumptions regarding the size of personal financial assets did not differ as much from reality as those for the GDP and the stock market. While we assumed that personal financial assets would increase by 14% over the three years, the reality was a 4% decrease. The expected shift in assets toward securities hardly became a reality. However, while this is a reflection of the difficult past of the Japanese securities industry, we also believe it indicates huge potential growth. Despite the large drop in share prices, the amount of personal financial assets did not decrease very much simply because the money held by individuals mostly remained in risk-free financial products.

Assumptions vs. Actual Results of Personal Financial Assets



Assessment of Performance and the Lessons Learned over the Past Three Years

Retail Client Assets under Custody and the Net Inflow of Retail Funds



Retail Securities Business : Operational Efforts Have Been Rewarded but Not Enough

In addition to the consolidated ROE and credit rating targets mentioned earlier, the Daiwa Securities Group had another goal in its previous medium-term management plan: increasing its retail assets under custody. At the end of FY 1999, retail client assets under custody totaled ¥14.7 trillion. Our aim was to double this amount to ¥28.3 trillion by the end of FY 2002. Instead, as of the end of FY 2002, these client assets declined 17% over the three-year period to ¥12.1 trillion, leaving us to reflect on why we missed our target by such a large margin.

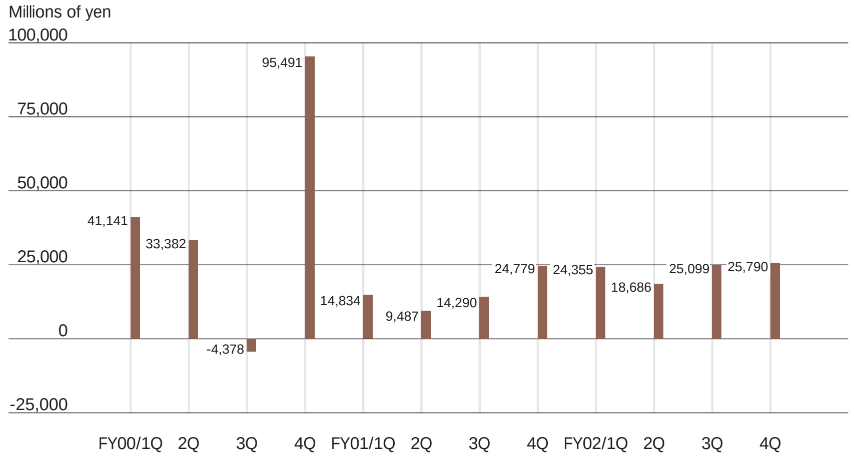
In fact, however, value of client assets tend to be volatile depending on share price movement. The decline in value, therefore, cannot entirely be blamed on inadequate effort. Since the amount of client assets is subject to large inflows and outflows as a result of (1) purchases, (2) withdrawals and (3) selling and various other factors, it is not easy to analyze the impact of external and internal factors. We would like to point out, however, that the TOPIX index fell 39% during the three years of our medium-term plan, while the value of retail assets under custody shrank slightly less than 20%. In our opinion, this result indicates that our efforts to increase assets under custody were not unsuccessful. In fact, the net inflow of retail funds came to ¥2.7 trillion over the three years. Despite our efforts, however, we believe our accomplishments remain far too limited. We are aware that there is a lot of room for improvement in the attractiveness of our products and services. We believe that making improvements in these areas is an important part of moving forwards.

In order to examine what can be done to make our products and services more appealing to our customers, we began to conduct in-depth customer satisfaction surveys three years ago as part of our branding activities. From the surveys, we have learned that our products and services can be improved in quite a few ways. The survey details are presented in Special Feature II (from page 23).

Trading Gains : A Recovery, but at a Low Level

Our net gain on trading securities increased more than 40% year over year in FY 2000, only to then sustain a sharp drop of more than 60% in FY 2001. We are well aware that large fluctuations in trading gains such as these must be addressed as they could become a serious problem, destabilizing our overall revenues. While we should of course take advantage of business opportunities such as those related to the unwinding of cross shareholdings and other business opportunities, inter-departmental collaboration within Daiwa Securities SMBC and inter-company collaboration between Daiwa Securities SMBC and Daiwa Securities are both essential to achieve stable revenues. In FY 2001 as well as in FY 2002, we strengthened this collaboration by making some organizational and personnel changes. As a result, FY 2002 trading gains rebounded to grow 48% year over year to ¥93.9 billion, earnings volatility in each quarter of the term was minimized and, above all, collaboration with Daiwa Securities delivered positive benefits. Nevertheless, despite reaching higher levels, our trading gains were disappointing relative to the level of ¥165.6 billion achieved in FY 2000.

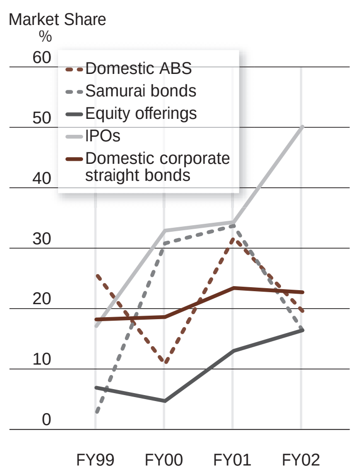
Trading Gains over the Past Three Years (quarterly)



Favorable Growth in Some Areas of Our Wholesale Securities Business

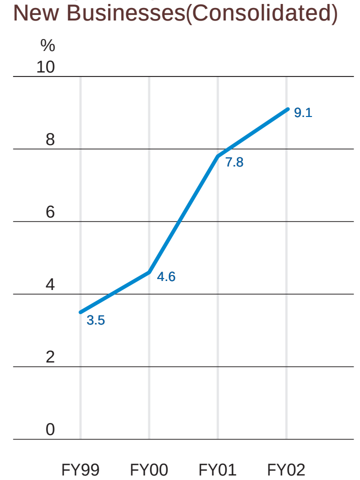
In areas outside of trading, our wholesale securities business generally achieved solid growth. The lead manager league tables (ranked on the basis of pricing date) for the last three years reveal that our presense has increased significantly. In terms of market share, we improved from 18.2% to 22.7% in the corporate straight bonds category and from 17.1% to 50.1% in initial public offerings (IPOs). In each of these categories plus in domestic public ABS issuance(bookrunner), we were at the top of the league tables in FY 2002. We were second in equity offerings and the Samurai bond categories, but nevertheless managed to improve our market share in both categories, from 6.9% to 16.4% in the former and from 2.6% to 16.4% in the latter. Another important element in achieving sustainable growth is diversification of the revenue stream. We expected that four new areas of business—M&A, structured finance, derivatives and principal finance—would contribute to diversifying our revenue stream. In fact, these new businesses did start to generate sharp revenue increases over the past three fiscal years and accounted for slightly more than 9% of net operating revenues in FY 2002, up from 3.5% in FY 1999 (consolidated basis).

Market Share of
Lead Managed Issues (value)

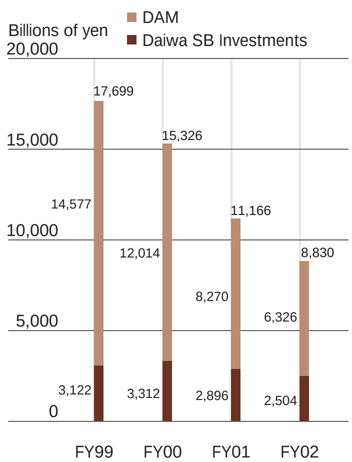


Source: Daiwa Securities SMBC,
THOMSON DealWatch for Domestic ABS(bookrunner)

Percentage of
Net Operating Revenue from
New Businesses(Consolidated)



Assets under Management



Asset Management Business : An Extremely Adverse Setback

Daiwa Asset Management Co. Ltd. (DAM) and Daiwa SB Investments Ltd. (Daiwa SB Investments), our two asset management companies, continued to experience punishing business conditions. DAM especially suffered from the adverse business environment, recording declines in equity investment trusts under management. DAM also posted a 60% reduction in fixed income investment trusts under management over the three-year period ended FY2002. This was due to Japan's prolonged near zero interest rates and a drop in value below par of a competitor's MMF (money management funds), triggered by the bankruptcy of Enron during FY 2001. While the industry as a whole continues to be plagued by extremely unfavorable business conditions, we believe we can improve our asset management business by developing products structured to meet customers' needs and by building a more effective marketing structure through stronger inter-company cooperation within the Group.

Assessment of Balance Sheet Reforms over the Past Three Years

The Meaning of Balance Sheet Reform

We improved our balance sheet by reducing risk assets and external debt unnecessary for our core businesses. Taking steps to ensure greater financial health and capital efficiency is essential to provide our customers with a sense of security. Furthermore, we believe that establishing a stronger relationship with our customers will lead to the attainment of sustainable growth, which will benefit all of our stakeholders.

Core Financial Strategy

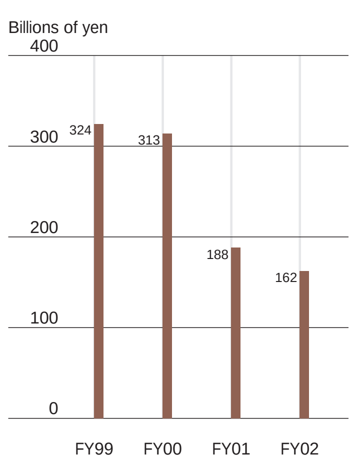
The largest risk asset in our Group is trading assets included in current assets, most of which are held by the wholesale securities company. As trading is one of our core businesses, we plan to proactively engage in trading operations backed by transactions with clients, while carrying out sound risk management. The large fluctuations in our trading positions are due to changes in our clients' trading activities as well as our product strategy. Our venture capital and private equity businesses engage in direct investments. These important risk assets are accounted for as "operational investment securities" in current assets and as "other investments" in fixed assets and have not been subject to excessive reductions. To the contrary, as we believe that (1) it is inevitable that corporate demand for business restructuring will increase in the future and (2) we will be able to take full advantage of our management analysis and business restructuring know-how in this field, we expect investments in this area to grow under appropriate risk management control.

Our core strategy is to improve our financial health and capital efficiency by reducing risk assets in non-core businesses, both in tangible fixed assets and investment securities such as real estate and cross-shareholdings, while expanding investments in potential growth areas of our core businesses.

Restructuring of the Real Estate Business Is Close to Completion

The value of our tangible fixed assets (consolidated basis) almost halved, from ¥324.5 billion at the end of FY 1999 to ¥162.3 billion at the end of FY 2002. This reduction came about as a result of our decision in the second half of FY 2001 to withdraw from the business of leasing real estate to non-group companies and to dispose of the related assets. This decision, not anticipated at the time our previous medium-term management plan was for-

Tangible Assets (consolidated)



mulated, was made to prepare for an accelerated adoption of asset impairment accounting. In the second quarter of FY 2001, we recorded ¥127.4 billion in extraordinary losses as an expense related to the reorganization of our real estate business. At that time, the book value of the assets was revised to the estimated sales value of ¥36 billion, based on the discount cash flow method. By the end of FY 2002, we disposed of approximately ¥32 billion. With the remaining balance at ¥4 billion, we believe that the real estate restructuring of the Group is near completion.

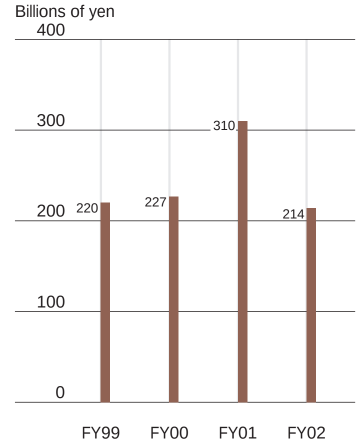
The Value of Investment Securities Declined 30% (excluding bank subordinated debt held by DAM)

Investment securities at the end of FY 2002 stood at ¥214.4 billion, almost unchanged from the end of FY 1999 amount of ¥220 billion. However, this reflects DAM's purchase of bank subordinated debt with a face value of ¥143.6 billion from its MMF portfolio in F2001 in response to new rules set by The Investment Trusts Association, Japan regarding MMF management. Roughly half of this subordinated debt was later sold to non-group companies. This subordinated debt purchase aside, the value of the Group's investment securities have decreased by slightly more than 30% over the last three years.

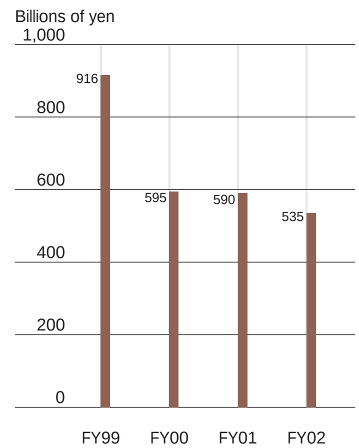
Despite a 42% Reduction, We Must Further Cut Our External Debt (excluding the two securities companies and NIF Ventures)

We reduced our external debt by 42%, from ¥916 billion at the end of FY 1999 to ¥535 billion at the end of FY 2002. This is 76% of our goal of ¥500 billion that we set in our previous medium-term management plan. The reasons why we fell short of this goal are, as previously mentioned, (1) the need for cash to purchase bank subordinated debt held in our MMF portfolio and (2) the failure to achieve our earnings targets. As mentioned in more detail in the Special Feature II section (from page 23), we will continue to take measures to reduce our external debt by making effective use of commitment facilities based on the Group CMS (cash management system).

Value of Investment Securities (consolidated)



External Debt (consolidated)



* Consolidated companies excluding Daiwa Securities, Daiwa Securities SMBC(including its subsidiaries) and NIF Ventures

Assessment of Other Issues Pertinent to the Past Three Years

Leveraging Our Marketing Operations and Adjusting Investments in Infrastructure

We did not stand idly by while the surrounding business environment diverged substantially from the scenario contained in our previous medium-term management plan. We made steady improvements in our balance sheet and took appropriate steps as necessary to put our marketing operations and investments in infrastructure on the right track.

● **Investment in Infrastructure:**
Adjustments to Our Infrastructure Investments

We initially pursued a program of infrastructural expansion on the assumption that business conditions would stage an impressive recovery. But, due to the prolonged sluggishness of the business environment, we changed course and brought our investments in computer systems down to a level lower than planned, but not to the extent that we would jeopardize our business growth potential.

● **Business Operations:**
Creating a Foundation for CS (Customer Satisfaction) Management

With respect to our sales activities at the retail company, we mainly revised the marketing structure in light of the slow pace of personal asset inflows we experienced relative to the size of the market potential. One measure that we implemented was the introduction of the "Satellite Branch System," in FY 2002. The purpose of this system is to create a more efficient marketing system, by organizing multiple branch offices operating in the same particular area into one operational marketing area under the control of a core (mother) branch. Under this system, each area can respond to customer needs more promptly and accurately by identifying area-specific customer characteristics. It is too early to quantify the beneficial effects of this system, but we are gradually constructing a database on the unique customer needs and attributes in each marketing area. Going into FY 2003, we are building a foundation based on management of customer satisfaction, a strategy we believe will differentiate ourselves from our competitors.

Personnel: Initial Plan vs. Actual

(persons)

FY99-end – actual –	FY02-end – initial plan – (A)	FY02-end – actual – (B)	(B)-(A)
13,019	13,662 (+643)	12,677 (-342)	-985

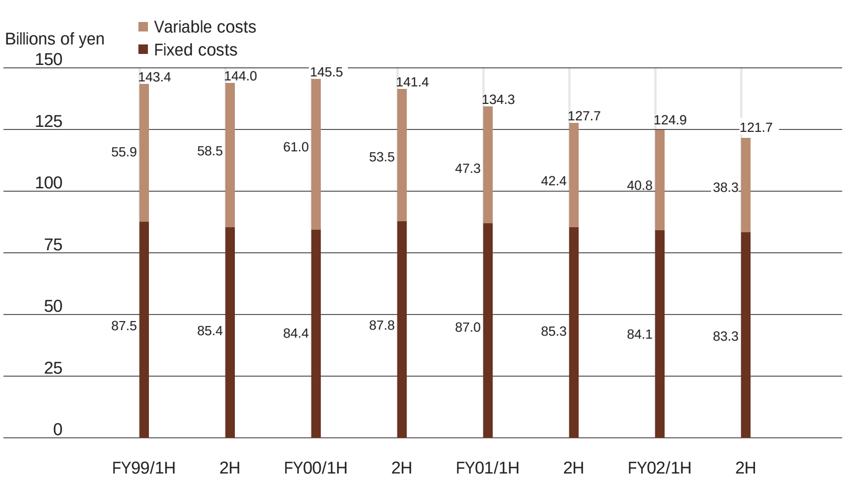
(change from FY99-end)

IT Investment Plan: Plan vs. Actual (for three years)

(Billions of yen)

– initial plan – (A)	– actual – (B)	(B)-(A)
131~151	91	-40~-60

Consolidated SG&A (fixed costs, variable costs)



<Variable costs> Commission and other expenses, personnel costs such as bonuses and costs for hiring part time workers.
<Fixed costs> Personnel costs such as wages and fringe benefits, real estate expenses, depreciation, tax other than income taxes

Cost Controls in Response to the Business Climate

In response to the worse-than-expected deterioration of the business climate, we have strengthened our cost controls. Specifically, we managed to reduce SG&A expenses on a consolidated basis from ¥287.4 billion in FY 1999 to ¥246.7 billion in FY 2002, a decline of approximately 14%. Personnel, office management and real estate related expenses are some of the areas where we succeeded in curbing costs.

In our previous medium-term management plan, we anticipated that an increase in staff levels in areas related to the securities business and aggressive investment in IT would cause personnel and depreciation expenses to rise substantially. However, owing to the deterioration in the business environment, we restrained new hiring and investments in computer systems that were either nonessential or not urgent. As a result, personnel costs and depreciation expenses for FY 2002 were below what we anticipated at the beginning of the previous medium-term management plan, the former by about ¥36 billion and the latter by about ¥9 billion. The lower personnel costs can be attributed to a reduction in the number of permanent employees and the changes made to convert fixed costs to variable costs (by, for example, making greater use of part-timers and tying a larger portion of bonuses to corporate earnings).

At the consolidated level, the total number of employees (including those at the equity-method subsidiary Daiwa SB Investments) declined by 342 over the three-year period, compared to the increase of 643 originally projected under our previous medium-term management plan. Although depreciation expenses rose over the same time period, additional IT investments amounted to ¥91 billion, which was below the range of ¥131 billion to ¥151 billion originally envisioned in the plan.