

# Brand Management and Sustainability

## Key Points

- Customer trust comes first in our Corporate Principles.
- Our holding company structure and spun off functions have made us more customer-oriented.
- Trust from customers and society builds the Group's brand.
- Brand management and sustainability are one and the same.

The Daiwa Securities Group puts more emphasis on customer trust than anything else. We believe that once we have trust, the Daiwa Securities Group brand starts to build itself. Moreover, we are working to win the trust not only of customers but also from society as a whole; this effort is contained in our pro-sustainability activities.

### Establishing new Corporate Principles

The Daiwa Securities Group's pro-sustainability activities date back to March 1998, when we established our new Corporate Principles. The previous year, the former Daiwa Securities<sup>1</sup> and some of its officers and employees had been accused of violating the Securities and Exchange Law and the Commercial Code after payments had been made to corporate racketeers. In the immediate wake of this incident, newly appointed President Yoshinari Hara announced his firm belief that "Society will never accept the securities industry if it continues to do business the old way. The thing Daiwa needs above all is trust from customers and society." The company established the Corporate Principles as its spiritual pillar, and the first item in the principles was and is the principle of customer trust.

<sup>1</sup> Now Daiwa Securities Group Inc.

### Corporate Principles

#### Customer trust

We stand on the trust of our customers. Prudently putting customer interests first and achieving a high standard of professional competence, we intend to become Japan's most appealing securities group at home and abroad.

#### Human values

People are the source of our competence. We highly value creative initiative by the individual, we cherish the challenging spirit and appreciate the capability and contributions of the individual.

#### Total compliance

We can be proud and prosper only when we achieve total compliance and gain the trust of our customers, our market and of our world society. We will maintain high standards of professional ethics and a fair code of conduct, thereby contributing to the development of our society.

#### Sound profit

Our fundamental objective is to enhance shareholder value through sound business operations. We will offer valuable services to our customers and earn adequate rewards for distribution to our shareholders.

### Brand Statement

We the Daiwa Securities Group are committed to acting as our clients' best partner and promoting their financial wellbeing. In order to achieve this, we shall redefine currently accepted best practice drawing on the following three core values.

#### We Shall Provide Products and Services that Exceed Expectations

It is important that we apply detailed knowledge of customer needs, innovation in our internal processes and a strong customer focus to provide solutions that routinely exceed customer expectations.

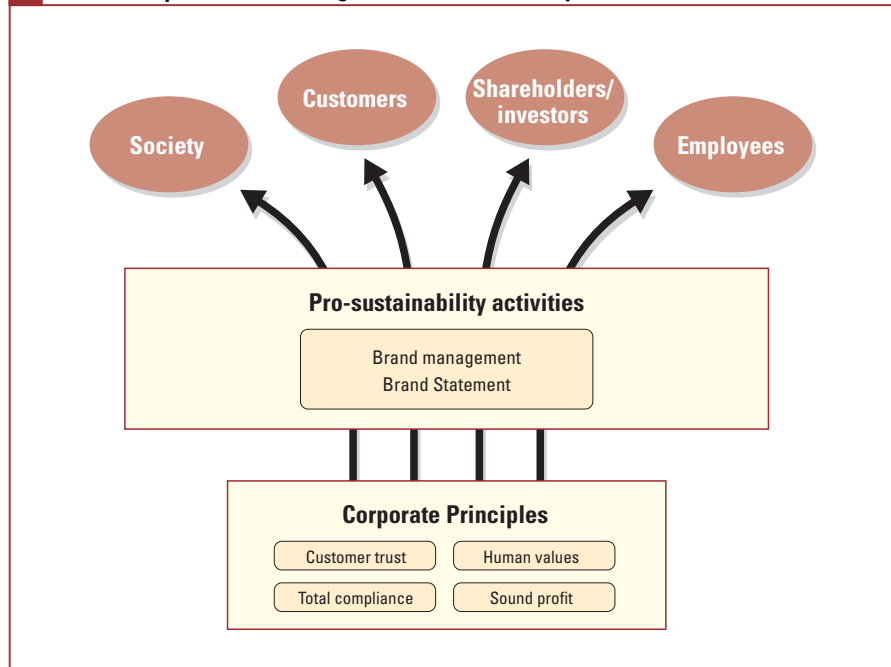
#### We Shall Bring the Full Strength of the Group to Bear

Cooperation among Group companies sweeping aside traditional corporate barriers, a flexible approach to business and swift decision making will enable us to offer comprehensive financial services precisely geared to meeting our customers' financial goals.

#### We Shall Continually Challenge the Limits of Financial Best Practice

Exploitation of our substantial store of professional knowledge and a pro-active approach to team building will enable us to remain pioneers in our marketplace.

### Chart of corporate brand management and sustainability



## Strengthening Corporate Governance: Adopting a Holding Company System

As regulations over the financial industry have been loosened and it has become more global, it has also become more competitive. The changing environment led us to seek a new business model in April 1999 by splitting the former Daiwa Securities into Daiwa Securities Co. Ltd. and Daiwa Securities SB Capital Markets Co. Ltd. (now Daiwa Securities SMBC Co. Ltd.) and moving to a holding company structure, the first such example among listed companies in Japan. The objective for this move was to adopt a group management system such as only a holding company could provide, and through this, enable strong corporate governance that would engender trust among our varied stakeholders. Additionally, by separating operations specifically for individual and corporate customers, we would be better able to serve these customers. Finally, we had determined that a group management system was the best for managing risk and enhancing the corporate value of the Daiwa Securities Group as a whole.

## Earning trust, building the Daiwa brand

As the Daiwa Securities Group sees it, the mission of the securities industry is to provide both capital procurement and asset management for our customers in a partnership based on trust. As we transition from an economy of indirect financing to one of direct financing, the securities market will play an increasingly important role. However, in Japanese society, indirect financing has had the more dominant role; individuals have generally avoided investing in risk-bearing securities, delaying growth of the securities market in proportion to the economy. We believe that part of the reason is, the securities industry in Japan has not tried hard enough to build trust in the securities market among investors or society.

In October 2000, having come to the conclusion that our most important task was to earn customer

trust in an industry dealing in risk-bearing financial instruments, we started the cross-company Corporate Branding Project to fix the image of our brand as worthy of trust. We followed up by issuing our Brand Statement, clearly expressing our promises to our customers, in March 2001.

One does not build a corporate brand in a day. Securities companies find it especially challenging to follow one management strategy consistently over the long term when market trends are affecting their short-term results. Such companies have to make persistent efforts to build a corporate organization that deserves trust, both as a long-term asset management partner and as a corporate citizen. What this means to the management team is that they must conduct business in adherence to a long-term vision; for employees, it means doing their day to day jobs in ways that meet the needs of stakeholders, including customers, shareholders, investors and local communities.

## Brand management =Sustainability management

Everything that the Daiwa Securities Group does in the name of brand management is completely consistent with our economic, social and environmental sustainability management.

As part of our branding activities, since FY 2001, the Group has given the Best Brand Daiwa award to departments and offices helping to build the Daiwa brand. Our efforts on behalf of sustainability—contributing to communities and society, increasing employee motivation—have won high praise (see below). We believe these activities lead to deeper stakeholder trust and are crucial to elevating the Group's brand.

Thus, for the Daiwa Securities Group, brand management is one and the same with pro-sustainability management. With this understanding, in 2002 we celebrated 100 years of doing business and began looking ahead to the next 100 years. It was at this historic time that the Group released its first *Sustainability Report* and publicly expressed its commitment to sustainability.

### Best Brand Daiwa 2002, award for contributing to brand profile in FY 2002

#### Grand Prize

Efforts on Behalf of Brand Penetration Regionally

– Submission of "Securities Market Theory," special lecture at Kagawa University–  
(Daiwa Securities)

#### Excellence Award

Details of updating of "Shareholder Rewards Catalog" and Materialization of Brand  
(Daiwa Securities)

Working to create highly service-oriented sales outlets with local roots  
(Daiwa Securities)

Start of distribution of Bloomberg Yen Bond Fixing Price  
(Daiwa Securities SMBC)

Corporate investment in Ogihara Corporation  
(Daiwa Securities SMBC)

## Results, Issues and Targets

		Major results from FY 2002
<b>Compliance</b>	<b>Entire Group</b>	Group-wide Corporate Ethics Hotline internal reporting system set up.
	<b>Daiwa Securities</b>	Compliance Department staff members develop "Compliance Caravan." Compliance committees held at each branch office.
		Customer interview system substantially improved.
		Compliance Department increases staff for branch office checking and advising from four to 14 members.
	<b>Daiwa Securities SMBC</b>	Strengthened information risk management. Stricter control over employee ID cards, implementation of information security self-checks, etc.
		Established stricter control over information, including data in computers and servers.
Strengthened system of monitoring securities trading by employees and their families.		
		Gave centralized compliance training.
		Implemented internal auditing system based on self-assessments.
<b>Corporate Governance</b>	Appointment of first Outside Director and reduction of director terms from two years to one.	
	Establishment of new medium-term management plan—Best Brand Daiwa 2005.	
	Decision to implement payment in shares of our stock system as part of executive compensation following advice of Compensation Committee.	
	Establishment of Internal Audit Department at holding company to promote internal control in Group	
	Establishment of Internal Control Project and Internal Audit Rule	
<b>Information Disclosure</b>	Webcast of teleconference with institutional investors and analysts on day business results announced.	
	Shareholders allowed to cast votes by Internet on general shareholder meeting decisions.	
	First <i>Sustainability Report</i> of the Daiwa Securities Group issued.	
	Individual shareholders surveyed	
<b>Core Business</b>	Mrs. Green eco fund begun in June 2001.	
	Four regional index funds begun.	
	Supported Tokyo international conference of the Association for Sustainable & Responsible Investment in Asia (ASrIA).	
	Organized Japan's first company visits by investors committed to sustainable and responsible investment.	
	Surveyed institutional investors interested in SRI.	
	Established industrial-academic ties with more than 20 universities and graduate schools.	
<b>Customer Satisfaction</b>	Expanded support for establishment of investment clubs to 174 clubs.	
	Began publishing "Tento (Shop) Weekly", an employee newsletter for improving service quality at sales offices.	
	Gave second customer satisfaction survey and determined areas to emphasize.	
<b>Daiwa People</b>	Daiwa Securities places second among securities companies in Nikkei Financial Daily study of financial institution branch service.	
	Average employment rate of persons with disabilities at nine Group companies rose 0.15 points over previous year (1.69% as of end of March 2003).	
	Percentage of women in career-track and regional career-track employment programs among employees in Japan rose, and female managers rose by three (as of end of March 2003).	
	Period during which parents exempted from overtime work extended from first two to first three years of child's life.	
	Began joint training for new employees at nine companies. Strengthened programs in corporate principles, ethics and social responsibility.	
	Cumulative graduates of Daiwa Leadership Program rose to about 150. About 10% of Deputy General Managers were graduates.	
	Added eight courses to Daiwa Securities' online training system @DESK.	
<b>Philanthropy and Community Involvement</b>	Established system linking employee bonuses to company performance.	
	Decided to reform personnel compensation based on work classification, and more detailed personnel evaluations (to be fully implemented from FY 2004).	
	Provided 320 million yen for corporate citizen activities (about 1.1% of ordinary income).	
	Continued community affairs programs as part of new employee training and wheelchair experience in managers' training.	
	Continued sign language courses and guide dog experience courses in Tokyo, Osaka and Nagoya.	
<b>Environment</b>	Daiwa Securities Health Foundation provided 30 grants worth 30 million yen. Daiwa Securities Foundation gave 202 grants worth 52 million yen.	
	Daiwa Anglo-Japanese Foundation has sent 81 British students to Japan for study through the Daiwa Scholarships.	
	Sponsored Marc Chagall exhibition to honor Group centennial.	
<b>Environment</b>	Expanded scope of our environmental performance data. Added branch offices of Daiwa Securities and four buildings to collection locations.	
	Submitted Global Warming Action Program for three buildings to Tokyo Metropolitan Government.	
	Continued to support "Saving Forest Giants," a giant tree preservation program.	
	Took part in cleanups at Kujukurihama Beach, Mt. Rokko, etc.	

\*Dates are provided for items already performed as of July 2003.

Issues and targets for FY 2003 and beyond*	Page in report
Provide systematic compliance training. Perform internal process-check inspections. Revise a compliance manual. Establish voluntary action standards. Changed affiliation of internal administration supervisors and methods of their personnel evaluation (April 2003). Systemize compliance training. Give division and theme-specific training, offer online training, etc. Revise inspection items and frequency based on regular self-assessments by each unit.	10~15
Increase Outside Directors from one to two (out of total of seven directors) (June 2003). Disclose total director and corporate auditor compensation (June 2003). Move to a "committee system" and establish Nominating, Compensation and Audit Committees. Perform results evaluation in accordance with new medium-term management plan. Establish a Corporate Governance Principle. Prepare Group-wide risk assessment, control and monitoring systems.	16~17
Held Experts' Roundtable with outside experts on environmental issues, social contributions, consumer issues and so on (April 2003). Start a new rewards program for shareholders (beginning FY 2003). Took first place in Gómez Japan's first securities company IR site ranking (May 2003). Establish a Disclosure Policy to provide standards and methods for information disclosure. Enhanced information on and improved user-friendliness of IR website.	18~19
Proposed elimination of double taxation on dividends, introduction of investment trust sales through post offices, etc. (April-June 2003). Signed agreement with Fukuoka Prefecture on support to attract system-on-chip companies (May 2003). Invested US\$2.5 million in World Bank carbon fund (July 2003). Support economics/financial education for young people (elementary school through high school students). Support socially responsible investing.	22~23
Established "customer retention rate" as an indicator of retail branch performance (April 2003). Transferred Customer Satisfaction (CS) Promotion Department from Compliance Division to Marketing Division (June 2003). Hold third customer satisfaction survey. Consider degree of customer satisfaction in assessments of retail branches and employees.	24~25
Raise average employment rate of persons with disabilities at nine companies to 1.8%. Promote women, by naming them as management candidates, etc. Graduated 20% of Deputy General Managers through Daiwa Leadership Program. Enrich programs designed for enhancing ability of consulting and asset management. Implement reform of personnel compensation (on left), and develop multi-directional assessment system. Greatly expand intra-Group job posting Study Nominating Committee operations system and director selection standards.	26~29
Sponsored performances by opera company Fondazione Teatro Lirico "Giuseppe Verdi" Trieste (May-June 2003). Support economics/investment education more actively. Provide more volunteer opportunities to interested employees.	30~31
Conduct company environmental campaign "Do Something Good for the Environment" (May 2003). Joined the Green Purchasing Network (June 2003). Establish a basic green purchasing policy and develop green purchasing. Introduce an Environmental Management System, study setting up a department of environmental management. FY 2004 greenhouse gas reduction targets at Group's three buildings: 0.1%, 1.9%, 2.0% respectively	32~35

## Addressing Issues and Setting Targets

The Daiwa Securities Group is working in many ways to enhance the sustainability of both society and the Group itself. We see disclosure of the Group's issues and targets as a key part of our responsibility to explain ourselves to our stakeholders.

In FY 2002 our efforts focused primarily on strengthening our systems of corporate governance and legal compliance. For example, we established a new medium-term management plan (for FY 2003-2005), implemented an internal reporting system (the Corporate Ethics Hotline) and set up an Internal Audit Department. Additionally, we have established regional index funds and supported the diffusion of socially responsible investing in Japan as part of our efforts to fulfill the mission of the securities industry but also to revitalize the Japanese economy.

In FY 2003 and beyond, we will conduct our pro-sustainability efforts within our core business by enriching our economics and investing education programs. Moreover, in keeping with our corporate branding action plan, we will continue to promote customer satisfaction, create workplace conditions that encourage employee pride and morale, and reduce environmental burdens caused by corporate activities.

## Compliance

In FY 2002 Daiwa Securities SMBC and Daiwa Securities were found to have deviated significantly from the Group's goal of brand management. To foster a corporate culture that will not allow such a thing to happen again, we are working to step up the Group's overall compliance system.

### Branding requires an established compliance system

One of the pillars of the Daiwa Securities Group's Corporate Principles is "total compliance," under which the Group promises that "it will maintain high standards of professional ethics and a fair code of conduct, thereby contributing to the development of our society." Creating the internal standards and rules needed to comply with the law, guiding and raising the consciousness of employees and monitoring their work are major preconditions of corporate activity. Compliance as it is

### Key Points

- The Group discovered incidents of deviation from the principles of brand management.
- A Group-wide Corporate Ethics Hotline internal reporting system was set up.
- We have adopted stronger control over undisclosed corporate information to prevent insider trading.
- We have substantially improved our customer interview system by branch managers and other sales supervisors.

meant to be practiced in the Daiwa Securities Group means that all employees respect the law and regulations in their day to day work, and that they do so with a strong sense of ethics.

At Daiwa Securities Group, we consider a strong system of compliance to be the key issue in our quest for brand management. Therefore, we have established a Group ethics code, built compliance systems suited to the business characteristics of each Group company, trained management and employees, and incorporated compliance into performance evaluations<sup>1</sup>. Regrettably, in spite of all these efforts, Daiwa Securities SMBC and Daiwa Securities were found to have deviated significantly from the Group's sought-after ideal of brand management. We humbly apologize to our stakeholders for the problems this has caused.

Below we report on these incidents and on specific efforts the Group is making to strengthen its compliance system, including how we deal with such incidents internally and measures for preventing them in the future.

<sup>1</sup> For details see pages 18-21 of *Daiwa Securities Group Sustainability Report 2002*.

### Administrative sanctions against Daiwa Securities SMBC

In May 2003 Daiwa Securities SMBC's former General Manager of the Institutions Department and the former Deputy General Manager of the Strategic Advisory (M&A) Department were indicted on charges of using undisclosed corporate information<sup>2</sup> to violate restrictions against insider trading. In June, the Financial Services Agency of Japan ruled on this case, saying that Daiwa Securities SMBC's control over such information was insufficient to prevent the unfair trades. Actions taken against Daiwa Securities SMBC were the suspension of business for one day in the Institutions Department (Section 1-7) and the Strategic Advisory (M&A) Department and an order to improve business practices. In response, Daiwa Securities SMBC halted operations in the above departments and submitted a Business Improvement Report to the Financial Services Agency detailing prevention measures and what it would do internally in response to the incidents.

Internally, the former General Manager was given the equivalent of a disciplinary dismissal (since he was "on-loan" from another company), but no action could be taken against the Deputy General Manager, because he had resigned before his case was discovered. Internal actions were also taken against Daiwa

Securities SMBC, especially the officers responsible for overseeing the related divisions at the time the incident occurred. Directors at Daiwa Securities Group Inc. also forfeited a portion of their compensation since they too had an oversight role as directors of the parent company.

A measure already in place to prevent insider trading at Daiwa Securities SMBC was to forbid employees from opening accounts at any securities company other than Daiwa Securities. Further internal rules that were in place included requiring employees to get permission from their superiors before buying or selling securities and a restriction on selling any stock within three months of purchase. Even so, the former General Manager and Deputy General Manager in this case both violated internal rules, failed to submit an application for approval of transaction and furthermore made these transactions through accounts at other securities firms, using names of family members. Internal monitoring failed to pick up these activities.

<sup>2</sup> Undisclosed corporate information: Information concerning a client company that is not publicly available but is learned in the course of doing business; this information, relating to mergers and acquisitions, corporate partnerships and so on, has the potential to greatly impact share prices.

#### **Fraud by Daiwa Securities contract employee**

A former contract employee at the Daiwa Securities branch at Nagoya Station was arrested in January 2003 on suspicion of investment fraud. According to authorities, starting in about 1987 the employee began telling customers about fictitious investments and had them deposit funds in her own bank account rather than Daiwa Securities customer accounts. In July 2002, after the employee had resigned, customers began to contact us about the situation, and Daiwa Securities responded by contacting the police and performing an internal investigation. In January 2003 the Nagoya District Public Prosecutor's Office indicted the former employee in Nagoya District Court on suspicion of fraud.

Although Daiwa Securities has in place a system whereby managers other than the sales person checks on customer accounts and all suspicious deposits and withdrawals can be checked, the system was unable to detect any irregularities because the money was not passing through Daiwa Securities accounts but straight into the employee's bank account.

#### **Embezzlement by former Daiwa Securities Deputy General Manager**

In January 2003 a former Deputy General Manager for Daiwa Securities' call center was reported to be under suspicion for embezzling approximately 80 million yen from the company. The former employee is accused of using another employee's ID card to access company payment system computers and transfer funds from company accounts to his own. Because Daiwa Securities checks account activity daily, the situation was discovered the next day. The former Deputy General Manager was immediately dismissed and the company filed with the police a complaint of fraud by computer. The suspect was arrested in May 2003.

**The Daiwa Securities Group profoundly regrets this series of incidents and is endeavoring to further strengthen its compliance system.**

# Compliance

## Further strengthening our compliance system

In light of the above incidents, the Daiwa Securities Group has become acutely aware that such incidents stem from employee problems and is taking concrete steps to buttress internal controls.

### Daiwa Securities Group Inc.: New systems and organizations

#### Implementation of a Group-wide Corporate Ethics Hotline

The Daiwa Securities Group introduced a Group-wide Corporate Ethics Hotline in January 2003. The hotline is intended to boost early detection,

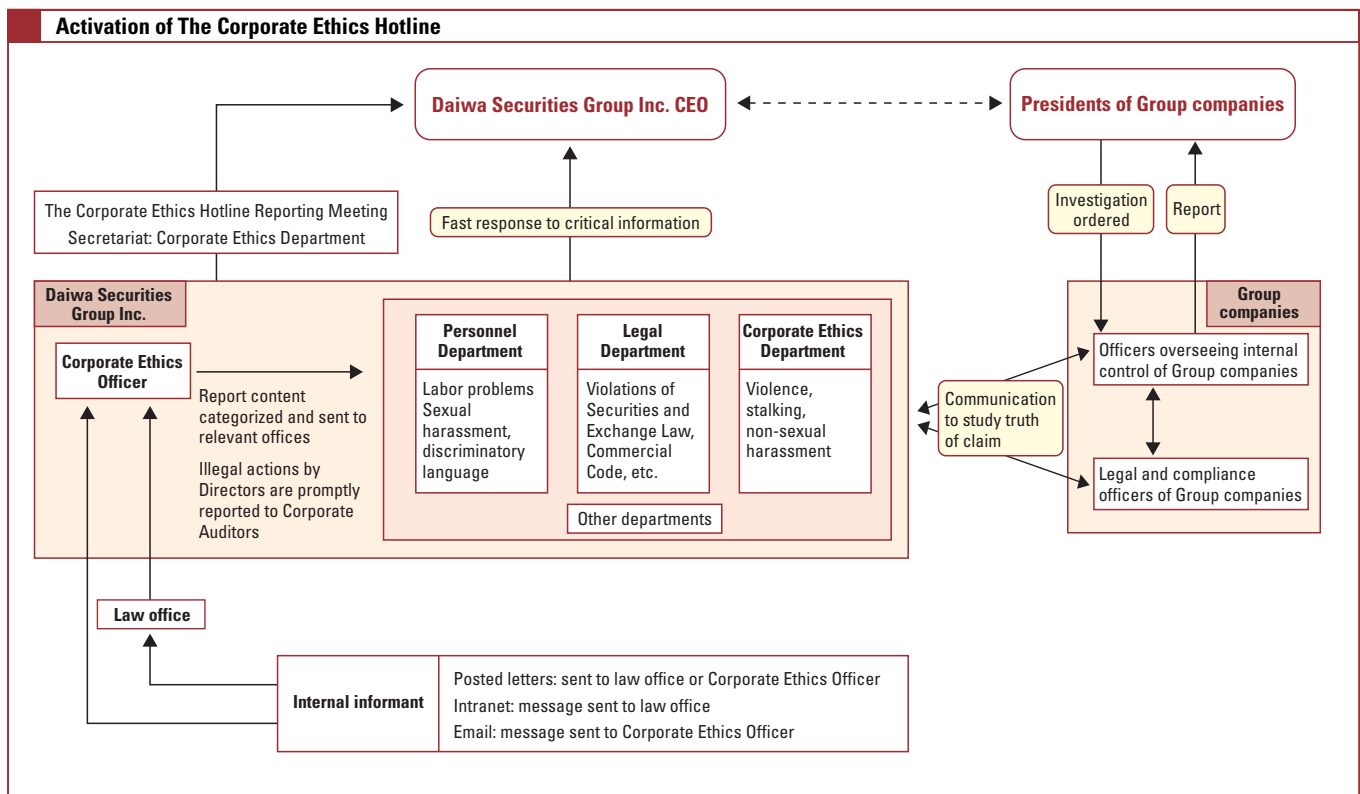
correction and deterrence of activities that are illegal or damaging to the Group brand. This system encourages the self-purifying function of our organizations.

Users can report information anonymously, and reported information is treated with the utmost confidentiality so that the informant does not suffer. The system is set up so that informants can use our intranet, email, post, telephone, or face to face interviews to contact either the Corporate Ethics Officer at Daiwa Securities Group Inc. or an outside law office. After receiving a report, the Corporate Ethics Officer at Daiwa Securities Group Inc. and compliance officers at Group companies work with each other to resolve the problem quickly. As of this writing (June 2003), in the first half year of operation, several reports had been fielded and handled appropriately.

## Establishment of Internal Audit Department

A new Internal Audit Department was established at Daiwa Securities Group Inc. in February 2003. It responds directly to the Board of Directors. An Internal Control Project began in March 2003, and presently, the Group is setting up an internal control and auditing system<sup>3</sup>.

<sup>3</sup> For details about the Internal Audit Department and Internal Control Project, see *Corporate Governance*, page 17.



## **Daiwa Securities SMBC: Information management and employee consciousness**

Daiwa Securities SMBC took the concrete steps below in FY 2002 to prevent problems from recurring. In addition to these, it issued the "Compliance Newsletter" to all employees to encourage a common awareness of problems company-wide.

### **Strict control of undisclosed corporate information**

Up to this time, Daiwa Securities SMBC had managed undisclosed corporate information by restricting it to the smallest possible number of people on a need-to-know basis. In addition, the company's Legal and Compliance Department had kept track of all individuals knowing this information. However, there had not been sufficiently strict control over employee access to information on our computer servers; this was a factor in the recent incidents. Therefore, the company has reviewed the scope of access rights and applied more stringent information control all the way down to the departmental LAN level.

In the past, when employees wished to make securities transactions, they had to get written permission in advance from their departmental heads. We have effected a change in which our investment banking employees must submit their applications for such transactions to the Legal and Compliance Department. This has strengthened early monitoring over transactions suspected of involving undisclosed corporate information. Other new requirements are that officers and employees must report to the company if their spouses or dependent children are opening accounts at securities companies, that transactions on these accounts are subject to monitoring, and that officers and employees must promise to cooperate when the company decides to investigate activity.

### **Assuring legal compliance with adequate training**

All employees transferring from Group companies, the Sumitomo Mitsui Financial Group and so on are given intensive compliance training. All marketing staff members are tested for training effectiveness after completing sales retraining to assure that this course is having the intended effect.

In FY 2003 Daiwa Securities SMBC is giving training tailored to specific departments and themes and offering online training as part of the greater systemization of compliance training. Starting in FY 2003, moreover, all officers and employees are required to sign promises of compliance once a year.

### **Boosting restraint with internal administration supervisors**

Internal administration supervisors earlier had been appointed to departments to create vital links in our internal restraint systems, but in April 2003, the affiliations and personnel assessment methods for these officers were modified. Rather than belonging solely to individual departments, internal administration supervisors are also now affiliated with the Legal and Compliance Department as well, and they receive their evaluations both from their own departmental head and from the General Manager of the Legal Compliance Department. These changes are making our restraint system with internal administration supervisors more effective.

Further, starting in April 2003, we have used the Legal and Compliance Officer to evaluate departmental heads on the issue of compliance. Standards during these appraisals include progress of the compliance program in the head's department, usage of internal administration supervisors and response to results of internal and external audits. These evaluation standards are announced within the company.

### **Development from voluntary checks to risk assessment-based internal check system**

A new system begun in October 2002 uses internal checks based on the results of departmental self-assessments. This program contrasts with the past practice in which each department performed its own voluntary checks. The new system takes each department's working characteristics into account, identifies inherent risks, and analyzes how well risk mitigation measures are working. The objective is to make effective checks of risk in proportion to type, extent of damage and frequency of occurrence. As the business environment changes, the inherent risks will also vary, so departments perform annual self-assessments. Check categories and frequency of checks are revised as needed.

## Compliance

### Daiwa Securities: Steps to build trust among customers

Daiwa Securities believes that earning customer trust is our most important task and has based its marketing efforts on the company's Solicitation Policy<sup>4</sup>. In order to prevent the recurrence of recent incidents, the company is working to bolster compliance management by engaging all employees. The key priorities of this effort are changing the consciousness and increasing the understanding of every employee and the early detection and prevention of improper actions. Daiwa Securities has advanced a company-wide compliance program since December 2002 conforming to the Financial Services Agency's securities inspection manual. With a goal of eliminating actions that break laws or rules or are otherwise inappropriate, in FY 2003 we are systematically giving compliance training, conducting internal inspections based on process checks and preparing our own compliance manual, among other actions. Under review is a plan to establish and announce voluntary action standards, an idea also under discussion by the Quality-of-Life Policy Council.

<sup>4</sup> For more information about our Solicitation Policy in Japanese, please visit [http://www.daiwa.co.jp/ja/access/onlinetrade/before\\_use/index-s.html](http://www.daiwa.co.jp/ja/access/onlinetrade/before_use/index-s.html).

### Stronger checks and leadership for branch offices

Daiwa Securities' Compliance Department has previously had a staff of four regional compliance officers (Deputy General Manager class) to inspect and give directions to branch offices, as well as internal administration supervisors at each office. In March 2003 the number of regional compliance officers was raised to 14. Because the persons added to staff had experience as branch office managers, they are better able to perform the check and leadership functions for branches both qualitatively and quantitatively.

### Strengthening voluntary efforts at branch offices

Daiwa Securities has established compliance committees at each branch office with the objective of enabling them to deal with issues independently. The Compliance Department provides leadership as needed.

### Improved face-to-face interviews with customers

Under Daiwa Securities' customer interview system, branch managers or others in a supervisory capacity interview customers directly to check on the solicitation styles of sales staff members and to look for any irregular transactions. Previously this system was directed only at certain customers, selected by such factors as transaction amount, but we have adopted a more flexible system where the supervisor can decide whom to interview at his or her own discretion<sup>5</sup>. During these interviews supervisors also show the customer recent values of the financial instruments they purchased and ask whether anything is unclear to them. The Compliance Department thoroughly checks records of these interviews. In addition to face-to-face interviews, supervisors sometimes check in with customers over the phone.

<sup>5</sup> The FY 2002 implementation of our Customer Relationship Management (CRM) System for all sales staff members has made it possible for supervisors to learn more efficiently about transactions between sales staff and customers.

### Encouraging compliance awareness and increasing understanding

The keywords for changing compliance awareness are "optimizing our sales attitude" and "respecting the basic rules of conformity<sup>6</sup>." In addition to group training, online learning and training by company satellite broadcasts, in October 2002, Daiwa Securities instituted the "Compliance Caravan," in which staff members of the Compliance Department visit sales branches to give training and advice. Two days are spent at each branch, checking the status of customer

transactions and giving training to employees. In FY 2002 the Compliance Caravan visited 33 branches.

In order to increase understanding about compliance and give employees common experience in the issues, Compliance Letters and Compliance Seminar (another publication) are regularly issued.

<sup>6</sup> The rules for investor protection spelled out in Article 43 of the Securities and Exchange Law. Securities companies are required to solicit investments in ways that are appropriate to the customer's understanding, experience, financial means and so on.

### Stronger information security risk management

Daiwa Securities has stepped up its risk management to prevent anyone from making illicit money transfers via a computer terminal. The company is making sure everyone is aware of strict management of employee ID cards and some departments are checked at random. In February 2003, management put all branch offices through "Information Security Self-Checks" to increase awareness of the information management system company-wide. Measures have been established to prevent incident recurrence by limiting the hours of the day during which money transfers can be entered and restricting the terminals used to transfer money at the head office to the Accounting & Finance Department.

## Other Group companies

### Daiwa Institute of Research: Stronger compliance in research

In March 2003 Daiwa Institute of Research transferred its Research Compliance Management Department from the Investment Research Division to the direct control of the representative directors. This lets our organization, including consulting staff, better handle internal and critical information throughout the research process.

### Compliance at asset management companies

To learn more about compliance systems at Daiwa Asset Management<sup>7</sup> and Daiwa SB Investments<sup>8</sup>, see those companies' respective web pages.

<sup>7</sup> <http://www.daiwa-am.co.jp/>

<sup>8</sup> <http://www.daiwasbi.co.jp/>

## Excerpt from a "Compliance Newsletter" circulated to Daiwa Securities SMBC employees\*

The Securities and Exchange Surveillance Commission, Financial Services Agency, Japan Securities Dealers Association and stock exchanges, among others, are actively monitoring market activity for illicit transactions. When an event of some significance happens to a particular corporation, these organizations ask securities companies to answer questions about transactions of the corporation's stocks for the designated peri-

od. Securities companies respond with details of purchases and sales. Daiwa Securities SMBC receives these requests nearly every day; in fact it is not unusual to receive 10 or more requests in a single day. Thus there are multiple layers of monitoring for illicit activity. Even if a transaction goes undetected within a company, it is sure to be found out.

According to newspaper accounts, two former employees are alleged to have made illic-

it transactions that netted them over two million yen and over three million yen respectively. These amounts are not much in comparison to the penalties they are paying for their actions.

\*From "Compliance Newsletter" No. 89, June 16, 2003



"Compliance Newsletter"

## Corporate Governance

The Daiwa Securities Group understands the importance of preparing a highly transparent and objective corporate governance system and using it to fulfill the social mission of the securities company and to increase corporate value.

### Our vision on corporate governance

The establishment of our corporate brand and the pursuit of sustainability are of the greatest concern for the Daiwa Securities Group. We believe that corporate governance can help us to achieve both of these goals through the processes of setting management policies and directing and assessing the way management do their jobs, as well as by giving extra motivation to management. That is why the Group has taken the following stance: "People and companies are imperfect, and merely creating systems is not enough to perfect them. What is important and indispensable is the process of trying to be perfect and working ceaselessly toward that goal."

### Key Points

- Our governance system based on business transparency and objectivity, emphasizes prompt decision-making.
- Executive compensation linked to performance and "payment in shares of our stock system" introduced.
- Internal Audit Department established to strengthen internal controls.
- Committee system to be adopted in FY 2004.

### Group management system and the Board

In 1999 the Daiwa Securities Group became the Japan's first listed company to adopt a holding company system. Under this system, Daiwa Securities Group Inc. oversees Group operations as a whole while allowing each Group company autonomy to concentrate on its appointed task. The number of Outside Directors was increased at the ordinary general meeting of shareholders in June 2003. The Board consists of seven Directors, two of whom are Outside Directors. Exceptionally small for a listed company, this board is the hub of a governance system based on business transparency and objectivity and emphasizing prompt decision-making. Under the Board's leadership, Group Executive Officers also take responsibility for operations at Group companies<sup>1</sup>.

<sup>1</sup> Refer to page 42 of the 2003 *Annual Report* for a listing of Daiwa Securities Group Inc. officers as of July 1, 2003.

### Executive compensation

Following the advice of the Compensation Committee<sup>2</sup>, the Daiwa Securities Group opted to link the compensation of Directors and Executive Officers to performance, beginning in June 2001. The total that these executives receive, in the form of monthly salaries, bonuses and retirement payments, goes up or down along with assessments of company and personal performance. Retirement payment is considered to be a deferred payment of part of each executive's annual compensation as based on performance during the period, so it no longer has the quality of being a "bonus for special services" typically given on retirement. The second feature of this system is that the Compensation Committee in FY 2002 implemented payment in shares of our stock, by which executives receive about 10% of their monthly pay not in cash but in company stock (beginning in July 2003)<sup>3</sup>. The purpose of this system is to tie executives' interests more closely to those of the shareholders and provide greater long-term incentive for maximizing shareholder value. The system prohibits executives from selling shares earned this way until they leave office.

<sup>2</sup> The Compensation Committee was established at Daiwa Securities Group Inc. in June 2000. See the page at the right for a list of Compensation Committee members as of July 1, 2003.

<sup>3</sup> Specifically, the corresponding amount of monthly salary is directed into a fund for purchasing shares of our stock through the Executive Shareholding Association.

### Total compensation paid to Daiwa Securities Group Inc. Directors and Corporate Auditors (FY 2002)

	Monthly salaries		Bonuses		Retirement payments	
	Recipients	Amount paid in year	Recipients	Amount paid	Recipients	Amount paid
Directors	10	205,080,000 yen	0	0	3	212,295,200 yen
Corporate Auditors	5	63,000,000 yen	—	—	1	14,400,000 yen

\* Recipients of monthly salaries include three directors and one corporate auditor who retired in midterm.

\* For employee-directors, no salary is paid for the employee portion.

\* Bonus payments were based on profit distribution as determined at the ordinary general meeting of shareholders in June 2002. Bonuses are not paid to Corporate Auditors.

## Strengthening internal control

The new Internal Audit Department was established within Daiwa Securities Group Inc. in February 2003 and answers directly to the Board of Directors. The role of this department is to coordinate with business planning and internal auditing departments within Group companies to plan and conduct internal audits.

Also, an Internal Control Project was begun at Daiwa Securities Group Inc. in March 2003 to create a system for getting a picture of and analyzing the Group's overall risk and applying appropriate control over it. Then in April the Group adopted its Internal Audit Rule, stating clearly the basic points to cover in internal audits. The goal is for these

audits to be as smooth and effective as possible. Additionally, an Internal Control Committee, headed up by the Daiwa Securities Group Inc. CEO, was founded in July 2003.

The Daiwa Securities Group will continue to step up its systems for assuring that 1) work is efficient and effective, 2) financial reporting is reliable and 3) laws and regulations are obeyed. With stronger control systems in place, we believe we will be able to meet the internal control requirements of the Commercial Code and the US Sarbanes-Oxley Act without difficulty.

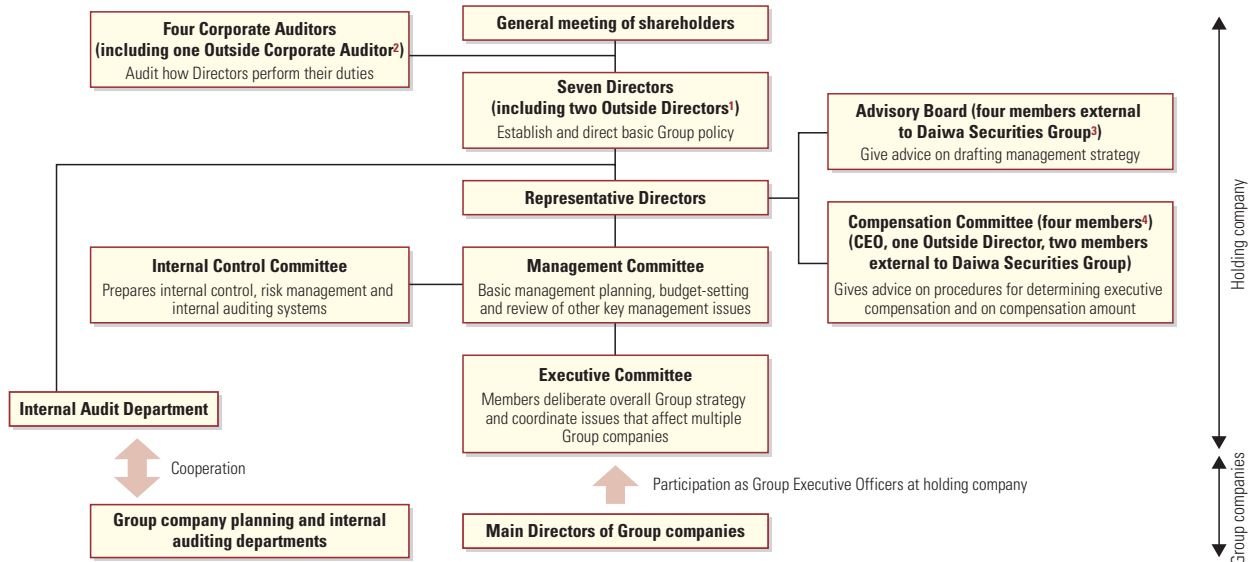
## Towards greater corporate governance

The Daiwa Securities Group is working to prepare the way for corporate governance and improve it.

Preparing a system of corporate governance is a key issue in the new medium-term management plan – “Best Brand Daiwa 2005.”

As a first step, the Group will be transitioning to a committee system in June 2004. The goal is to increase management speed, transparency and accountability. The second step is to adopt a “Corporate Governance Principle.” The Group will establish this charter in FY 2004 in order to make our corporate governance ideas and systems clearer to outside parties and to help the same ideas and systems become better known to all Group employees. FY 2003 is a time of doing prep work for this charter.

### Corporate governance system (July 2003)



#### 1 Outside Directors

**Tetsuro Kawakami**  
Counsel of Sumitomo Electric Industries, Ltd.

**Ryuji Yasuda**  
Chaired Visiting Professor, Hitotsubashi University Graduate School

#### 2 Outside Corporate Auditor

**Masahiro Yoshiike**  
President, Taiyo Life Insurance Co.

#### 3 Advisory Board

**Kazuo Inamori**  
Founder and Chairman Emeritus, Kyocera Corporation

**Jiro Ushio**  
Chairman and CEO, USHIO INC.

**Glen S. Fukushima**  
Chairman, Cadence Design Systems, (Japan) B.V.

**Hiroataka Takeuchi**  
Dean, Hitotsubashi University Graduate School of International Corporate Strategy

#### 4 Compensation Committee

**Ichiro Kawamoto**  
Attorney-at-Law, Senior Partner, Kawamoto & Miura

**Yukio Yanagida**  
Attorney-at-Law, Senior Partner, Yanagida & Nomura

**Ryuji Yasuda**  
Chaired Visiting Professor, Hitotsubashi University Graduate School and Outside Director, Daiwa Securities Group Inc.

**Yoshinari Hara**  
President and CEO, Daiwa Securities Group Inc.

# Information Disclosure

The Daiwa Securities Group is endeavoring to improve communication with its stakeholders. In FY 2002 we issued our first *Sustainability Report*, thus beginning full-fledged efforts to offer social and environmental sustainability information. In April, 2002 we merged our former investor relations and public affairs departments to form the new Corporate Communication Department and thus assure a unified message.

## Our vision on information disclosure

The Daiwa Securities Group believes that information disclosure should be made in a fair, appropriate and timely fashion. The Daiwa Securities Group Inc.'s IR website includes Our Commitment to Disclosure, although in FY 2003 the Group is establishing a more detailed Disclosure Policy. The Disclosure Policy will state that Group companies will have a common policy on information disclosure. It will prescribe the roles of information disclosure officers, standards and methods for information disclosure, and response to marketplace rumors. Thus, it will set up a more responsible information disclosure system.

## Our Commitment to Disclosure

1. We will abide by all laws and regulations such as the Securities and Exchange Laws and other regulations set by the Stock Exchanges on which the company is listed, and endeavor to achieve accurate and timely disclosure.
2. We will endeavor to understand the needs of our investors and provide fair disclosure in terms of both time and in content.
3. We will endeavor to utilize various forms of media such as the Internet, conferences and printed material to provide easy to access company information.
4. We will be conscious of its role as a leader in the securities market and endeavor to become a role model for other listed companies.

## Key Points

- In October 2002 we issued our first *Sustainability Report*.
- Gómez Japan ranked our IR website no. 1 among securities companies.
- We are starting a new rewards program for shareholders in FY 2003.
- We will establish our Disclosure Policy in FY 2003.

## Information disclosure with focus on triple bottom line<sup>1</sup>

The Daiwa Securities Group issued its first *Sustainability Report* in October 2002. Up until this time, we had reported on our efforts on behalf of corporate governance, our personnel system and our social contributions within our *Annual Report*. In FY 2002, with sustainability identified as a key business strategy, we decided that a more detailed report on social and environmental activities was needed. We wrote the *Sustainability Report* for our wide array of stakeholders, issuing 25,000 copies in Japanese and 3,000 in English. All employees received a copy, and an electronic version was loaded onto our IR website. In April 2003, we met with outside experts to discuss environmental issues, social contribution, con-

sumer issues and so on in an Experts' Roundtable<sup>2</sup>.

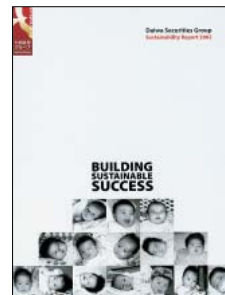
See below for the Group's information disclosure framework.

<sup>1</sup> Triple bottom line: An evaluation of a company not just from the economic perspective but also the social and environmental. John Elkington of the British environmental firm Sustain Ability first promoted this idea.

<sup>2</sup> For details see *Stakeholder Dialogue*, page 36.



Annual Report

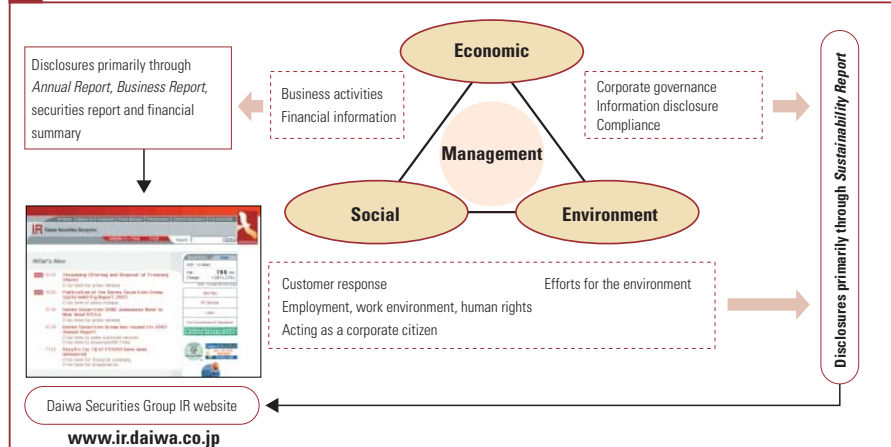


Sustainability Report



Business Report

## Daiwa Securities Group information disclosure framework



## Strengthening information disclosure

For the Daiwa Securities Group, the objective of information disclosure is not simply to release quarterly performance statements and important occasional business notices, but also to make Group strategy and trends easier to understand and to increase management transparency.

Immediately after such information is released, it is also posted to our IR website<sup>3</sup> so that it is available to all stakeholders, individuals and organizations, with hardly any time lag, thus eliminating differences in the information provided to different stakeholders. In the evening of the day our performance results are announced, we hold a teleconference for institutional investors, analysts and the media, but starting with our April 2002 release of results for FY 2001, we have also held a simulcast from our IR website for individual investors. We are constantly performing IR for stakeholders overseas as well, by keeping an English-language IR website, holding a teleconference in English the night (Tokyo time) after results are announced, and other measures. In FY 2002 we began to expand beyond Europe and America to offer IR in more regions of the world; in Asia we have made our first individual visits to investors in Singapore and Hong Kong.

In addition to teleconferences and strategy meetings, Daiwa Securities Group is committed to using the Internet to provide easy-to-understand information to more stakeholders in Japan and abroad. The Group's IR website took first place in Gómez Japan's first securities company IR site ranking in May 2003, while Daiwa Investor Relations Co., Ltd. honored the Group with its Internet IR Best Company Award for 2003. While the site received high praise for stability, fairness and volume of information, improving user-friendliness is still a concern. A survey given to individual shareholders in November 2002<sup>4</sup> found that 50.1% of respondents thought it was hard to find the information they required at the site.

Therefore, the Group will work on making this site easier.

<sup>3</sup> IR website: The Internet page in Japanese and English where we post earnings, information and audio/video of teleconferences, company information sessions, press releases and so on.

<sup>4</sup> Responses were received from approximately 8,300 individuals. For details refer to FY 2002 (66th Year) *Business Report*, page 16.

## Communicating with individual shareholders and investors

At the end of March 2003 individual shareholders of Daiwa Securities Group Inc. numbered 99,374, a gain of more than 5,000 from the previous year. (The number of all shareholders is 102,006.) The results of the individual shareholder survey given in November 2002 indicate that 67.9% had become shareholders in the company more than three years earlier, and 38.3% had done so more than 10 years earlier. Therefore, our shareholders have had their shares for a relatively long time. When asked the objective for acquiring their shares, 50.6% said they intended to hold their shares for the long term, while 28.3% were looking to make a profit by selling in the short term.

Regarding the general meeting of shareholders, which is an opportunity for shareholders to communicate with management, 89.6% of respondents said they had never attended a meeting and 43.2% had never exercised their voting rights. In FY 2002 we began to allow voting by Internet and to broadcast our general meeting of shareholders by satellite to locations in Osaka and Nagoya as ways to increase opportunities for communicating with individual shareholders. Besides these, we enlarged our *Business Report*, sent to investors twice a year, to a more readable A4 size.

In FY 2003 as a new shareholder rewards service we began offering exchangeable points in the "Daiwa Comprehensive Account Service (Cash Management Program) Port One" program. Customer rewards include a waiver of the account management fee. In these ways Daiwa Securities Group hopes to build long-term relationship with individuals not just as shareholders but as customers.

