



Commitment to the Development of a Sound Securities Market

Maintaining and developing a sound securities market is a key responsibility of the Daiwa Securities Group. In order to accomplish this, we must live up to the confidence placed in us by our customers and society by practicing compliance at a higher level than just complying with the laws and regulations.

Action with awareness of compliance by each of our employees will earn the confidence of our customers and society.

Because the industry is growing, creating a fair market is an especially important duty.

— **What do you think of compliance at Daiwa Securities?**



Masaki Shimazu
Senior Managing Director
Chief Compliance Officer
Member of the Board
Daiwa Securities Co., Ltd.

Shimazu: Compliance doesn't just mean complying with the letter of the law. Daiwa Securities Group's sense of compliance means all the actions to build a true relationship of trust with customers and society. It includes all the actions to be taken in order to establish a sound and reliable securities market, including an appropriate sales attitude that takes customer needs into

account, a check system to eliminate securities incidents and the like, and the elimination of antisocial forces.

As a company that deals with financial products, we must have a strong sense of ethics. After a long period of low interest rates, the flow from savings into investment is accelerating, and the ratio of direct financing is increasing. Precisely because this is a huge business opportunity, we also have a huge responsibility.

— **But don't salespeople tend to focus on profits?**

Shimazu: What would happen if our salespeople acted like the only thing that mattered was selling financial products? While performance might increase over the short term, selling products to customers who do not have a good sense of risk and return without informing them of the risks, and repeatedly performing

unnecessary trades, would cause our customers to lose faith in the act of investing itself, as well as their confidence in us. We don't give high ratings to employees who only create transient profits. We promote a system that rates employees on how well they propose investments that are suited to their customers, and how well they build a true relationship of trust, and this system is becoming universal throughout our organization.

— **What do you think the relationship is between the Daiwa Securities Group's sense of compliance, and legal compliance?**

Shimazu: Compliance fundamentally means living up to the trust of society. It does not simply mean "not breaking the law." It means every employee doing their jobs with the reasons why laws and rules were created firmly in mind. I believe that this will build a relationship of trust with our customers, and improve our sales capabilities.

Continually revising systems will achieve universal compliance.

— **What are you doing to firmly establish the concept of compliance among our front-line staff?**

Shimazu: We continually provide compliance training to everyone from junior employees up to management. We particularly emphasize to superiors that educating, checking, and protecting subordinates is a key attitude that enables our internal-control system to function. Our personnel evaluations also emphasize sales approach that is suited to their customers and compliance. We will also centralize the chain of command for our Sales Division and Compliance Division, and show a clear course of action.

Kagawa: Creating, managing, and continually revising internal rules is also part of compliance practices. Rules need to be

changed when new products are created, and when the market environment changes. We also focus on making our rules as simple and easy to understand as possible, because that makes them more effective.

— What kind of compliance system have you built at the organizational level?

Kagawa: We need a system to continually check whether our operations are being carried out appropriately. The Compliance Department in our headquarters has compliance officers who are responsible for the sales branches in each area and group. Each sales branch also has an internal administration supervisor. This role is separate from the branch manager, who is responsible for sales. The internal administration supervisors report to our Compliance Division each month.

Additionally, the Legal and Planning Section in the Compliance Department accepts consultations on laws and regulations from our sales branches, and the Examination Section accepts consultations on compliance operations. The Trade Surveillance Department responds to inquiries regarding share and other trades.

Maeda: In order to practice a customer-oriented sales approach, we have a system that requires sales staff to apply for authorization before switching products. Under this system, a salesperson must obtain



Takanobu Kagawa
General Manager
Compliance Department
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the authorization of the branch manager before recommending to the customer to sell a holding product, such as an investment trust, and purchase a new one. This prevents recommendations to inappropriately switch products, and also helps grow our assets by increasing the retention period of our investment trusts.



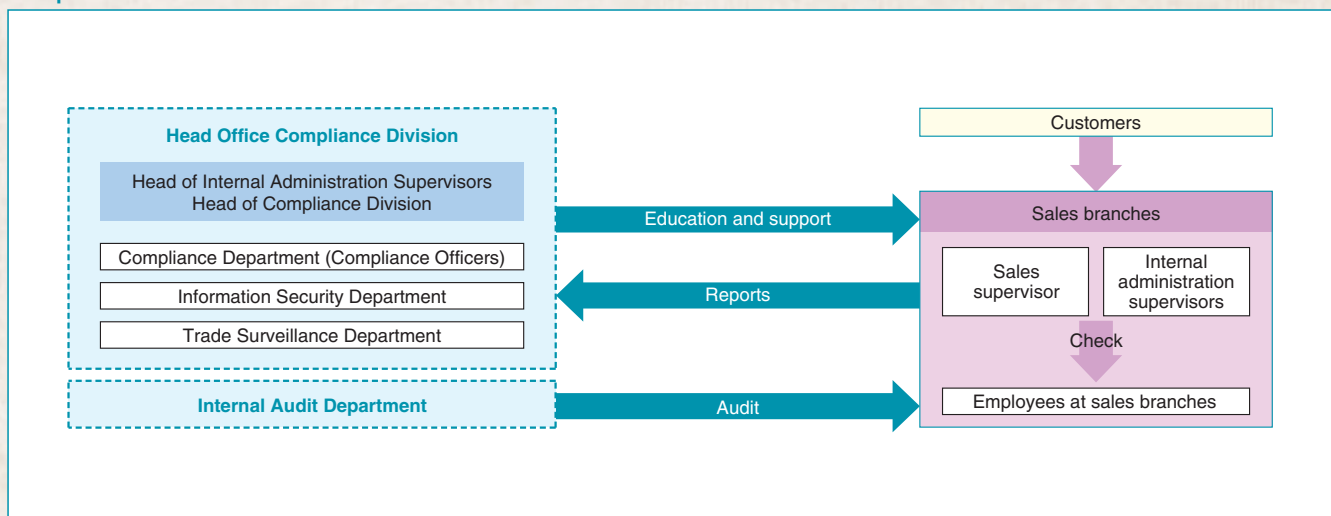
Atsushi Maeda
General Manager
Compliance Department
Daiwa Securities Co. Ltd.

We also perform sampling to check whether our trades match our customers' needs, and implement a system for consultations between superiors and customers.

— How do you judge the results of your initiatives?

Kagawa: One of the indicators we focus on is the number of telephone calls that our Customer Support Center receives from customers, and the details of the calls—inquiries, complaints, and so on (see page 15). Over 70% of all calls are inquiries, and the remaining slightly less than 30% are complaints. The proportion of complaints is declining, and I believe that this indicates that our initiatives are showing results. We also analyze the complaints, and this helps us find areas in need of improvement.

Compliance structure





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We take our administrative sanction very seriously. We will use it to create better mechanisms.

— What caused our Himeji branch to undergo administrative sanction (see page 16) in fiscal 2006?

Shimazu: It was caused by insufficient awareness within the branch of one of the most important duties of a securities company: to maintain the reliability of the securities market. The administrative sanction was for insider trading by a customer that we should have been able to prevent, but didn't. In subsequent training, we are emphasizing the importance of recognizing this duty we have to society.

— What was the reaction by employees like?

Maeda: Within two months of the incident, our directors visited every sales branch and personally conducted training, in order to thoroughly communicate the background of the incident, and that employees must exercise caution. This training was given to everyone, from managers, to salespeople, to drivers. People were



sent from nearby branches to staff the phones during training.

After the training, the employees were given questionnaires. The responses in the questionnaires showed us that the training gave many employees a renewed awareness of the need to remain conscious of compliance in all actions.

Shimazu: Based on this incident, we studied ways to enhance our internal control system, including personal identification and preventing illicit trading, from the perspective of the duties of branch managers and ensuring that our salespeople execute their duties appropriately, and we formulated measures to improve operations.

We take this incident very seriously, and we are committed to regaining trust by enhancing our structural regime in order to prevent illegal activities, and ensuring thorough knowledge and understanding of compliance and internal controls.

Outstanding compliance is a major business advantage.

— What are your future goals?

Shimazu: Outstanding compliance is a major business advantage. It makes us more valuable as consultants.

By having each individual understand his or her mission, and recognize and execute his or her duties based on this understanding, I believe that it is possible to differentiate the Daiwa Securities Group from our competitors on the strength of our compliance. Our goal is to make Daiwa Securities Co. Ltd. the finance industry's compliance leader.

Calls received by our Customer Support Center

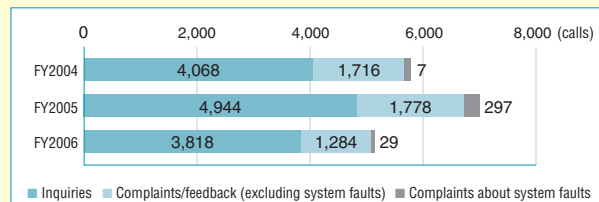
We focus on the analysis of calls received by our Customer Support Center as an indicator of the results of our compliance initiatives.

In fiscal 2006, our Customer Support Center received 5,131 calls. Of these, 3,818 were inquiries, and 1,313 were complaints. We believe that the reduction in the number of inquiries is a reflection of the decrease in trading due to the sluggish securities market.

The numbers of calls and complaints received by the Customer Support Center fluctuates due to variable factors, including increases or decreases in the numbers of trades, market trends and investment performance of financial products, system faults, and the like. For this reason, it is inappropriate to base evaluations on a simple comparison of numbers alone. However, we believe

that the decreasing trend in the ratio of complaints to total calls reflects successful results of our customer support initiatives.

Number of calls received by our Customer Support Center



Fiscal year	Ratio of complaints and feedback to total calls*
2004	29.6%
2005	25.3%
2006	25.0%

* Excluding complaints about system faults

Administrative sanction on Daiwa Securities Co. Ltd. by Financial Services Agency

In October 2005, an executive of a chemical manufacturer asked the assistant manager of the Himeji branch to open an account in the name of one of the manufacturer’s business partners, and placed a purchasing order for 1,500 shares of the manufacturer’s stock. Based on the way in which the account was opened and other factors, the branch assistant manager was suspicious that the executive of the chemical manufacturer was using this account under the business partner’s name. These actions were subject to sanction because “...accepted the customer’s security-trade order despite knowing the risk of insider trading.”

The FSA also determined that the Himeji branch manager

“...recognizes that not enough was done to prevent unfair trading relating to corporate information,” and further that the assistant manager “...accepted the customer’s security-trade order without confirming customer identity in accordance with the Customer Identification Law,” and that these actions were subject to sanction.

Daiwa Securities Co. Ltd. takes this administrative sanction very seriously, and we deeply regret the inconvenience we have caused our shareholders and everyone involved. In accordance with an order by the FSA to halt operations, we halted operations by our Himeji branch for two days: December 19 and 20, 2006.

Our response to business improvement order and correction order

We created a business improvement plan designed to prevent such violations from occurring again, and submitted a Business Improvement Report to the FSA on January 4, 2007. Below are described the business improvement order and correction order consequent to the administrative sanction, and our main responses to these orders.

We are committed to improving our internal management and checking system, and enhancing our regime to prevent violations from occurring, as well as ensuring thorough awareness of compliance in order for each employee to think carefully about the reasons behind laws and rules, act in accordance with commonly accepted norms, and build a relationship of trust with our customers and society.

Business improvement order and correction order	Main responses to the orders
Drastically revise the internal-control systems at the Himeji branch.	<ul style="list-style-type: none"> ● Created an Internal Control Improvement Committee at the Himeji branch We have created an Internal Control Improvement Committee at the Himeji branch. Every Monday, the branch manager and other persons in positions of responsibility meet, identifying issues for that week, and confirming the implementation status of issues from the previous week. ● Conducted training at Himeji branch During the halt of operations at the Himeji branch, all branch employees underwent compliance training.
Clearly identify the accountability for the facts causing the administrative sanction	<ul style="list-style-type: none"> ● Clearly identified accountability In order to clearly assign accountability to officers and employees, the compensation of seven directors was reduced from 5 to 10% for three months, and five employees involved in the incident received official reprimands or warnings.
Validate the internal control systems of our branches, and formulate and implement measures to prevent re-occurrence.	<ul style="list-style-type: none"> ● Revisions to internal regulations and systems We forbid employees in the Investment Banking Department involved with insider information from taking trade orders under any circumstances. ● Compartmentalization of information We compartmentalized information by physically separating the working environment of the Investment Banking personnel from that of the Brokerage personnel. ● Independence of Trade Auditing Department We made the Trade Auditing Department, which was part of the Compliance Department, independent, giving it a key role in checks against insider trading, and enhancing its trading control operations by increasing the department’s personnel from 8 to 14 people. ● Introduction of call recording system We will introduce a system capable of recording all telephone conversations with customers at all branches by September 2007. This will enable concrete recording-based monitoring.
Ensure through awareness of legal compliance by all officers and employees by means of training and other programs.	<ul style="list-style-type: none"> ● Conducted compliance training at all sales branches In order to learn well from this incident and ensure thorough knowledge and understanding of compliance, our directors visited all 117 branches nationwide within two months of the incident, providing compliance training to all employees.