Material Issue 2

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. To live up to the confidence placed in us by society, we are working to create a compliance system based on principles and to implement it at a higher level than merely statutory observance.

Ensuring Better Compliance, Not through More Rules but by Explaining Their Intent

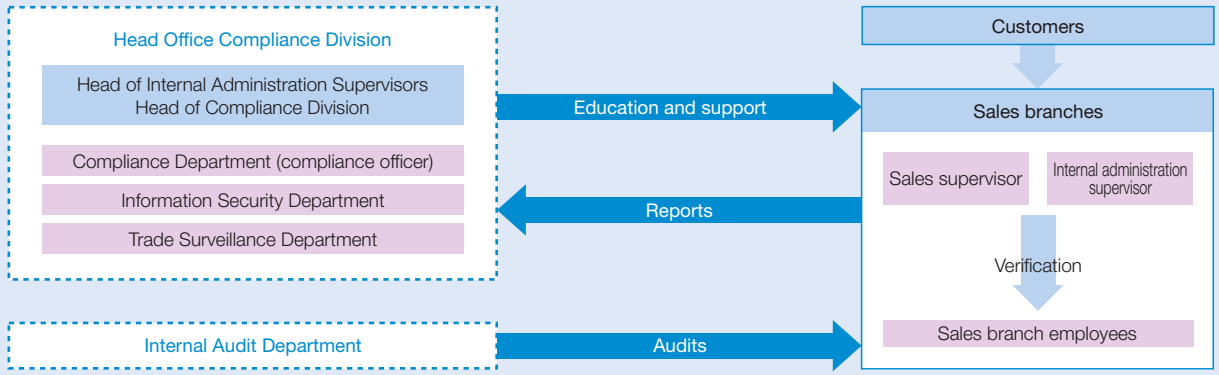
Masaki Shimazu
Senior Managing Director
Chief Compliance Officer
Member of the Board
Daiwa Securities Co. Ltd.

Change in Policy Regarding Method for Strengthening Internal Control Management

In fiscal 2007, we reviewed our policies regarding compliance activities to improve our internal control system. Following activities that successfully raised compliance awareness among our salespeople, we have gradually shifted the focus of our activities from uncovering problems to providing guidance and support for establishing internal control best practices in day-to-day sales operations in our aim to improve our compliance system. To prepare for implementation of this policy, we also simplified rules and procedures. Our previous practice had been to set down rules covering even the minutest points and control salespeople's actions based on those rules. But we found that not only does having a multitude of rules obscure what those rules are intended for, salespeople were having difficulty remembering them and sometimes found themselves in violation because they were not aware of a particular rule. Simplifying rules and procedures has reduced such occurrences and helped salespeople develop better knowledge of the intent behind the rules. This, I believe, has fulfilled our original aim and improved our compliance system.

Reviewing our policy in this area was also a conscious message on our part that the sales department and the compliance department are working together to improve internal control. The two departments should always think and act together—it's not a question of the former going full speed ahead and the latter acting as the brake. I feel that these measures have helped bridge the distance, in a positive way, between the sales branches and the compliance department.

Compliance Structure



Improving the Internal Control System in Accordance with Government Policy

We have basically acted in accordance with our own policies, although some of them are based on the views of the Financial Services Agency (FSA).

Today, the FSA says that a combination of rule- and principle-based supervision is the best solution for internal control. In other words, the FSA believes that rules and regulations should be kept to a minimum and that fundamentally, the securities business should be principle-based. In April 2008, the FSA released a document titled "The Principles in the Financial Services Industry," whose content is basically common-sense information. Naturally, this does not imply that our sales operations should simply remain within the law; we must ensure that we act according to principles and socially accepted norms. I believe that we should aim for a simple, clear and effective internal control system rather than one that is rule-bound, and I agree with the FSA's principle-based approach.

Issues for Fiscal 2008

Our operations are highly regulated, but we need to understand the reasons for the rules and regulations so that in sales we can put the customer first. In fiscal 2008, we intend to continue our initiatives carried out in 2007, concentrating on activities to help understand why rules and regulations exist.

Another important topic that must be addressed is improving the system for monitoring unlawful transactions. Insider trading and other unlawful transactions are a major social problem. Given that a public-interest role of securities companies is their market intermediation function, we devote many resources to employee training relating to unfair trading practices. Measures to eliminate unfair trading practices, including shutting out criminal elements, will become even more important in the future.

Business Continuity Plan

To ensure the safety of customers and Group executives and employees and protect assets, and in view of the public-interest aspect of our business as a securities company, Daiwa Securities has drawn up a business continuity plan (BCP) prioritizing important operations to be restored or continued in the event of a natural disaster, in order to keep the securities market functioning and protect customers' economic activities.

By putting our data in electronic form, we believe that we have the most advanced BCP in the financial industry. In addition to a backup center following best practice in Japan, we have created a structure allowing us to continue vital operations through an entirely separate system than the one we use for normal operations, should head office functions be impaired.

Expected Disasters and Damages

Our BCP will go into effect in the event that our sales branches are damaged or our head office/head office functions and/or our data center are affected and become inoperative due to earthquakes, fires, wind and water damage, abnormal weather, outbreaks of contagious disease, acts of terrorism, or major power failures or other breakdowns in essential services.

Priority Operations to be Restored or Continued

1. Market settlement of securities transactions contracted but not delivered
2. Payment operations
3. New orders from customers to sell or to liquidate long positions on margin transactions for the products below:
   - Domestic listed equities
   - MRF (money reserve funds), MMF (money market funds), medium-term government bond funds
   - Japanese government bonds for individual investors