Financial Section

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Management's Discussion and Analysis

Macroeconomic Conditions

1. Japan

The Japanese economy, having stayed level since the latter half of FY 2004, broke through and forged ahead in the first half of FY 2005, driven by steady growth of both internal and external demand. For the year, real GDP grew 3.2%, well above official estimates for the potential growth rate, which had been below 2%.

Exports stagnated temporarily as the Chinese government took measures to restrain that nation's overheated economy. Due to ongoing economic expansion overseas, however, exports for the year showed relatively solid growth, benefiting in the second half of the period from the recovery in earnings of IT-related companies, as well as an increase in exports to China. Production in the mining and industrial sectors again showed clear growth amid ongoing inventory adjustments by IT-related firms.

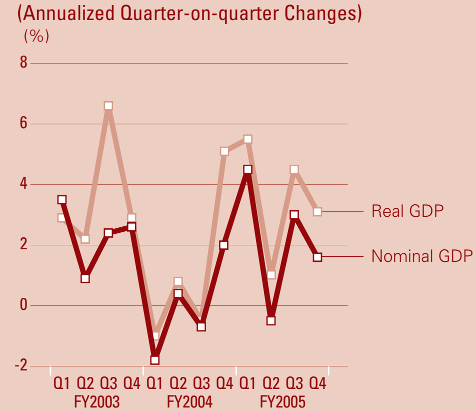
Corporate earnings rose for the fourth consecutive year from FY 2002, despite increases in the prices of crude oil and other raw materials. Indeed, the average ratio of ordinary income to net sales in FY 2005 surpassed the level attained at the peak of the "bubble" economy. Major manufacturing companies received higher dividends and royalties from their overseas subsidiaries and, with the added benefit of the yen's depreciation in the second half of the period, reported strong earnings. In this environment, business sentiment showed general overall improvement, notwithstanding differences according to sector, company size, and geographical location.

The year saw continued high growth in capital expenditures, underpinned by increased capacity utilization rates and high levels of earnings, and backed by growth in internal and external demand. Within the manufacturing sector, materials and processing companies recorded strong growth. Among non-manufacturers, the solid performers were companies in the real estate, information and communications, and electricity and gas sectors. During the year, corporations also made effective use of cash flows to upgrade their production and sales operations and to pursue research and development to reinforce their competitive edge.

Meanwhile, favorable corporate performances led to increases in dividends and share prices, boosting household income and the value of assets held. As the "good times" of the business world flowed into household budgets, personal consumption gradually bottomed out and firmed, and sentiment among companies in the consumer sector also improved.

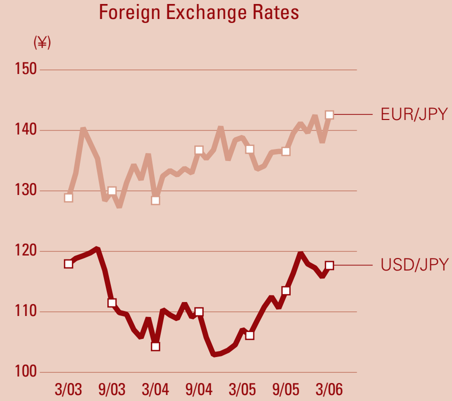
Despite weakness early in the fiscal year, the stock market gath-

GDP
(Annualized Quarter-on-quarter Changes)



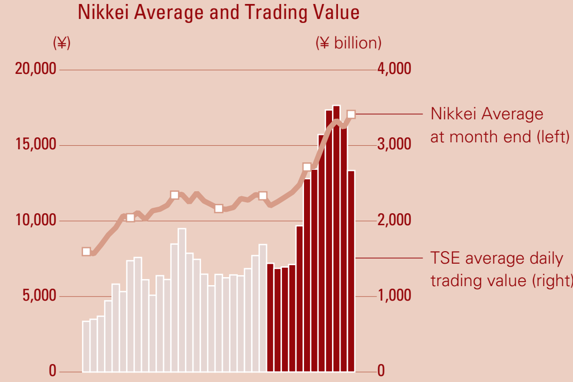
Source: Cabinet Office, Government of Japan

Foreign Exchange Rates



Source: Bloomberg

Nikkei Average and Trading Value



Source: Tokyo Stock Exchange, Bloomberg

ered steam since July 2005 and remained vibrant. Over the period, the Nikkei Average surged 46%, to ¥17,059.66 on March 31, 2006, from ¥11,668.95 on March 31, 2005. Moreover, the average daily trading value on the Tokyo Stock Exchange jumped 68.7% year on year, to ¥2,404.5 billion — the highest in the history.

In the bond market, the yield on 10-year Japanese government bonds (JGBs) fell from 1.3% at the beginning of the period to below 1.2% by June 30, 2005 (as bond prices increased), but subsequently turned around as expectations of rising interest rates—stemming from economic recovery and rising share prices—pushed yields up (while bond prices declined). By March 31, 2006, the yield on 10-year JGBs had grown to around the middle of 1.7% to 1.8%, boosted also by the Bank of Japan's decision to lift its quantitative monetary easing policy.

2. Overseas

In the first half of FY 2005, the world economy showed signs of slowing due to economic deceleration in Europe and North America, as well as measures to tighten the overheated Chinese economy. Despite external imbalances, the United States, as the driver of the global economy, delivered another year of growth above 3%, underpinned by strong personal consumption. With the added benefit of completed inventory adjustments by IT-related companies, the world economy again turned around in the latter half of the period.

Meanwhile, brisk activity in crude oil and commodities markets underscored a succession of record-high prices for resources. The central banks of various nations responded by raising interest rates to alleviate concerns about inflation.

Consolidated Operating Results

1. Overview

In FY 2005, strong stock market activity helped spark a rapid recovery in the earnings of securities companies. In this context, the Daiwa Securities Group reported substantial business growth. Ordinary income amounted to ¥260.6 billion, a 2.2-fold increase from FY 2004, while net income jumped 2.7-fold, to ¥139.9 billion. Consolidated return on equity (ROE) for the year rose considerably, to 19.4%, maintaining the highest among Japan's top 3 major securities companies. Cash dividend for the year was increased to ¥34 per share, greatly exceeding the previous record of ¥14, paid in FY 1989 and 1990.

2. Individual Accounting Items

(1) Net Operating Revenues

Consolidated net operating revenues in FY 2005 amounted ¥579.3 billion, up 48.4% from FY 2004. Within this total, commissions grew 42.9%, to ¥309.1 billion. Revenues from the equity division were solid, benefiting from the vibrant stock market, while revenue from the asset management division rose significantly, boosted by higher sales of equity investment trusts and the balance of net assets. The Group continued expanding its investment banking operations amid firm growth in underwriting deals and expansion of M&A activities. Net gain on trading continued growing steadily, reaching ¥224.9 billion in the year under review. Contributing factors included Structured Principal Solution (SPS) Program by Daiwa Securities SMBC, increased sales of foreign currency-denominated bonds by Daiwa Securities, and increased securities intermediation businesses for institutional customers of Sumitomo Mitsui Banking Corporation. Net gain on private equity and other securities, related to operating investment securities held by Daiwa Securities SMBC Principal Investments and NIF SMBC Ventures, also rose considerably.

Breakdown of Net Operating Revenues

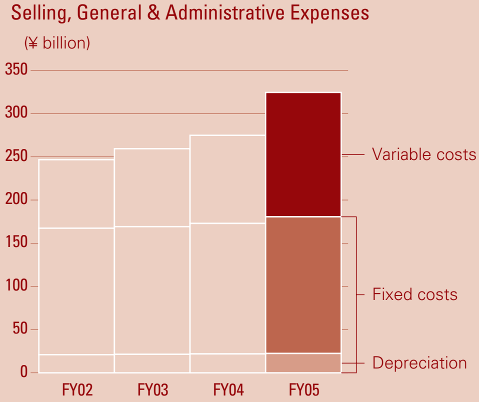
(Millions of yen)

				FY2005			
	FY2004	FY2005	yoy	Q1	Q2	Q3	Q4
Commissions	216,387	309,189	42.9%	45,039	62,944	89,853	111,351
Net gain on trading	151,117	224,912	48.8%	35,804	68,547	57,749	62,810
Net financial income	14,342	13,638	-4.9%	4,434	2,975	3,444	2,785
Others	8,584	31,618	268.3%	6,004	4,223	11,726	9,665
Total	390,432	579,359	48.4%	91,282	138,689	162,773	186,612

(2) Selling, General, and Administrative (SG&A) Expenses

SG&A expenses increased 18.0% year on year, to ¥325.1 billion, but the rate of increase was significantly lower than that of operating revenue growth. Major factors in this rise included a 36.8% increase year on year of fees and commission paid including commissions paid to third parties and advertising expenses, and a rise in performance-linked bonuses and other variable costs. By contrast, the increases in fixed costs were limited, with real estate expenses edging down 0.1% and depreciation up 2.3%. SG&A expenses accounted for 56.1% of net operating revenues, down considerably from 70.6% in FY 2004.

Selling, General & Administrative Expenses



(3) Ordinary Income and Net Income

Ordinary income surged 116.4%, to ¥260.6 billion, the highest since the Group moved to a holding company structure in 1999. For the year, the Group posted a net extraordinary loss of ¥2.2 billion. This was mainly due to a ¥6.8 billion impairment loss on facilities that the Group has decided to stop using, such as welfare facilities and underutilized suburban employee dormitories. Another factor was a ¥4.4 billion one-time amortization of the Group's head office building to shorten estimated remaining useful life following a decision to shift to a new location. Consequently, net income soared 165.7%, to ¥139.9 billion.

Ordinary Income and Net Income

(Millions of yen)

				FY2005			
	FY2004	FY2005	yoy	Q1	Q2	Q3	Q4
Ordinary income	120,433	260,651	116.4%	23,800	60,155	78,407	98,287
Net income	52,665	139,948	165.7%	11,636	34,185	38,803	55,322

Trends by Business, Group Company, and Geographical Segment

(1) Breakdown of Commission Revenues

Equity commissions grew substantially, rising 43.3% year on year, to ¥120.2 billion. Brisk stock market activity, characterized by record-high average daily trading value on the Tokyo Stock Exchange (TSE), led to this expansion in brokerage commissions. During the year, Daiwa Securities revamped the fee structure of its Daiwa Direct course, introducing the flat-fee system. While this caused the average commission rate to decline, trading volume increased significantly, driven by online transactions. Daiwa Securities' share of total TSE market transactions grew as a result. The net inflow of retail assets at Daiwa Securities fell from ¥2,309.7 billion in FY 2004 to ¥1,886.1 billion in FY 2005, but this was due to the sudden increase in deposits of tansu-kabu (equity certificates held physically by investors) in the third quarter of FY 2004. Indeed, the net inflow/outflow of funds was ¥1,367.9 billion, up considerably from ¥696.1 billion in FY 2004, signaling healthy growth in new fund inflows.

Asset management commissions surged 80.6%, to ¥82.4 billion. Sales of bond investment trusts, such as Daiwa Global Bond Fund, as well as equity investment trusts, such as Japanese equity funds and an emerging market funds, grew strongly, boosting distribution commissions. In addition, rising share prices and fund inflow led to expansion of net assets under management, boosting management fees including agency commissions.

Investment banking commissions in FY 2005 grew 16.2%, to ¥82.7 billion, rising for the second consecutive year. Underwriting commissions related to primary and secondary equity offerings, which were solid in the previous year, performed even more strongly in the year under review. During the year, the Group handled a number of large-scale issues, which also boosted underwriting commissions. Meanwhile, commissions from M&As continued to increase. In the lead-manager league tables, we secured the No.1 position in total corporate bonds for the third successive year, and also seized the No.1 spot for IPOs.

Breakdown of Commission Revenues

(Millions of yen)

				FY2005			
	FY2004	FY2005	yoy	Q1	Q2	Q3	Q4
Equity	83,887	120,217	43.3%	17,964	26,301	39,075	36,874
Fixed income (Bond)	4,264	3,202	-24.9%	717	1,008	741	735
Asset management	45,640	82,404	80.6%	14,689	18,053	23,600	26,059
Investment banking	71,170	82,735	16.2%	8,231	13,830	21,193	39,479
Others	11,426	20,631	80.6%	3,436	3,749	5,243	8,202
Total	216,387	309,189	42.9%	45,039	62,944	89,853	111,351

(2) Performances of Major Group Companies

Daiwa Securities, which handles the Group's retail securities business, posted operating revenues of ¥258.9 billion, up 57.1%, and ordinary income of ¥101.0 billion, up 317.3%. Revenues increased across the board amid favorable market conditions. Sales of equity investment trusts exceeded ¥2 trillion, up substantially from over ¥800 billion in FY 2004. Sales of foreign currency-denominated bonds also surpassed the previous year's level, and the balance of margin positions outstanding grew significantly for online trading. With respect to "Daiwa SMA", a wrap account service for high-net-worth customers, the contract assets under management surged to ¥159.1 billion as of March 31, 2006.

Daiwa Securities SMBC, which conducts the Group's wholesale securities business, reported a 40.5% increase in operating revenues, to ¥350.8 billion, and a 66.2% jump in ordinary income, to ¥141.5 billion. These figures include the results of its consolidated overseas subsidiaries, as well as Daiwa Securities SMBC Principal Investments, a domestic consolidated subsidiary involved mainly in the principal investment business. Similar to the retail business, revenues were up across the board. Increased trading revenues and investment banking-related revenues provided a major boost to results. The major portion of revenues of Daiwa Securities SMBC Principal Investments derives from net gain on private equity and other securities, which showed solid growth. The company's investment amount as of March 31, 2006 was ¥310 billion, up ¥220 billion from a year earlier, due mainly to large-scale investments in such companies as SANYO Electric and Sumitomo Mitsui Construction.

In the asset management business, Daiwa Asset Management reported ordinary income of ¥4.4 billion, around three times the figure of the previous year. The company enjoyed sharp growth in assets under management owing to an increase in sales of equity investment trusts by Daiwa Securities and rising stock market prices. Its assets under management of equity investment trusts jumped two-fold, to ¥4.2 trillion as of March 31, 2006, providing a significant boost to management fees. Daiwa SB Investments, another Group member in the asset management business, posted a 93.7% jump in ordinary income, to ¥4.6 billion.

Performances of Major Group Companies

(Millions of yen)

	Daiwa Securities		Daiwa Securities SMBC (Consolidated)		Daiwa Asset Management	
	FY2004	FY2005	FY2004	FY2005	FY2004	FY2005
Operating revenues	164,792	258,943	249,649	350,818	19,316	31,374
Ordinary income	24,216	101,057	85,176	141,582	1,490	4,435
Net income	13,863	58,174	54,034	91,883	1,220	3,051

(Millions of yen)

	Daiwa Institute of Research		Daiwa SB Investments*		NIF SMBC Ventures	
	FY2004	FY2005	FY2004	FY2005	FY2004	FY2005
Operating revenues	64,386	78,915	11,888	16,247	4,407	9,356
Ordinary income	5,329	7,325	2,381	4,613	32	4,800
Net income (loss)	2,871	4,315	1,434	2,752	(8,491)	6,689

*Equity-method subsidiary

(3) Overseas Performance

Total ordinary income of the Group's overseas operations—covering the three major regions of North America, Europe, and Asia and Oceania—surged 100.5% to ¥16.3 billion. The Group reported significant year-on-year growth in all three regions, with investment banking performing particularly well due to an increase in the number of underwriting issues.

Ordinary Income by Geographical Region

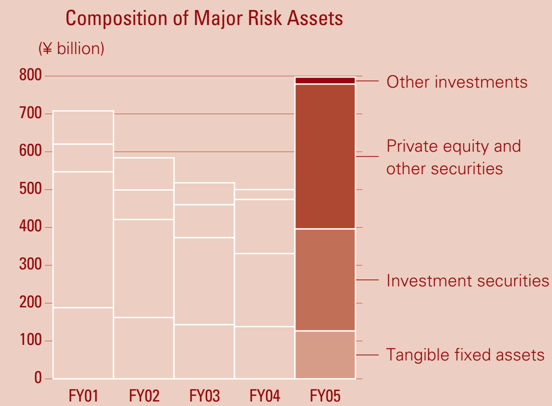
(Millions of yen)

	FY2004	FY2005
America	270	2,695
Europe	5,941	10,185
Asia & Oceania	1,928	3,442
Total	8,140	16,322

Balance Sheet and Cash Flows

(1) Assets

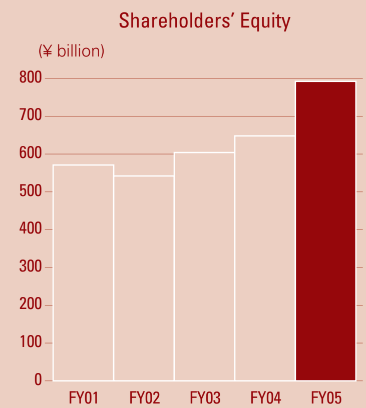
As of the end of March 2006, the Daiwa Securities Group had total assets of ¥14,898.8 billion, up ¥2,519.9 billion from a year earlier. Within this amount, total current assets grew ¥2,456.3 billion, to ¥14,392.3 billion, and non-current assets climbed ¥63.5 billion to ¥506.4 billion. Addressing vibrant demand from investors, the Group increased its trading positions, centering on Daiwa Securities SMBC, leading to a ¥919.9 billion year-on-year increase in trading assets. Receivables on collateralized securities transactions grew ¥925.5 billion.



(2) Liabilities and Shareholders' Equity

At fiscal year-end, total liabilities stood at ¥13,869.8 billion, up ¥2,328.4 billion from a year earlier. Current liabilities rose ¥2,127.3 billion, to ¥12,812.9 billion, and non-current liabilities were up ¥199.7 billion, to ¥1,049.9 billion. Major factors boosting current liabilities were trading liabilities (up ¥1,220.6 billion) and payables on collateralized securities transactions (up ¥866.2 billion). Short-term borrowings, meanwhile, declined ¥500.6 billion. The main reason for the rise in trading liabilities was an increase in short positions to hedge against long positions in government bonds. The increase in non-current liabilities stemmed largely from a ¥100 billion issuance of straight bonds.

Total shareholders' equity rose ¥143.9 billion, to ¥792.2 billion. Main contributing factors were net income of ¥139.9 billion and a ¥37.0 billion rise in net unrealized gain on securities owing to the strong stock market. These factors outweighed the downward impact of ¥26.6 billion in payments of cash dividends.



(3) Cash Flows

Cash flows from operating activities produced a net cash inflow of ¥368.7 billion, compared with a net outflow of ¥1,018.6 billion in the previous fiscal year.

Despite a decline in time deposits, purchase of investment securities led to a net cash outflow of ¥952 million, from the previous outflow of ¥10.2 billion.

Cash flows from financing activities showed a net cash outflow of ¥322.9 billion, compared with a net cash inflow of ¥883.8 billion in the previous fiscal year.

Cash and cash equivalents (after deducting exchange rate changes on cash) at fiscal year-end totaled ¥392.3 billion, up ¥53.6 billion from a year earlier.

Cash Flows

(Millions of yen)

	FY2004	FY2005
Cash flows from operating activities	(1,018,676)	368,790
Cash flows from investing activities	(10,276)	(952)
Cash flows from financing activities	883,869	(322,945)
Cash and cash equivalents at end of term	338,697	392,350

Capital Investments

The Daiwa Securities Group's capital investment activities are based on several objectives, including building a foundation for raising competitiveness and enhancing convenience for customers. In FY 2005, the Group made a total of ¥34.9 billion in IT-related expenditures. These included investments to reinforce online trading systems at Daiwa Securities, upgrade systems for handling "Daiwa SMA" and other new products, and strengthen trading systems at Daiwa Securities SMBC, as well as ongoing spending to modernize the Group's core operating systems. The Group also invested ¥3.5 billion in branches and other areas. As a result, total capital investments for the year amounted to ¥38.4 billion.

Risk Management

(1) Risk Management System

The Daiwa Securities Group faces various risks in the course of its business activities. The Group is aware that it is important to identify, evaluate, and properly manage these risks in order to maintain healthy financial and earnings structures. Of these risks, market risk, credit risk, liquidity risk, operational risk, system risk, legal risk, and reputation risk, in particular, are controlled primarily by the subsidiaries of the Daiwa Securities Group. All subsidiaries have established their own systems for managing various types of risks according to the characteristics and risk profiles of their respective businesses. Daiwa Securities Group Inc., in turn, controls the Group's overall risk by monitoring the risk management systems and processes of its subsidiaries.

At Daiwa Securities Group Inc., business plans of the Group, including consolidated budgets, are determined by the Board of Directors, which also decides on regulations concerning risk management and matters related to other systems. Based on the progress status of basic matters decided upon by the Board and the business plans of each division, the Executive Committee determines allocation of capital and other managerial resources. Details of the Group's risk exposure are reported to and discussed by the Internal Control Committee. This information is important to the Executive Committee in determining resource allocation.

Because the Group engages mainly in the securities-related business, market and credit risks stemming from trading activities are especially important. Thus, it is imperative for the Group to manage these risks effectively to ensure financial health.

Daiwa Securities SMBC, Daiwa Securities SMBC Europe Limited, and Daiwa America Corporation carry out most of the trading within the Daiwa Securities Group. Daiwa Securities takes relatively small trading positions in situations where market risk exposure exists. Moreover, because transactions with its customers are backed by sufficient collateral, market risk and credit risk emanating from such trading are limited.

Daiwa Securities SMBC is responsible for its own risk management and that of its subsidiaries. The main authority related to risk management rests with the Risk Management Committee, which determines risk management policy, procedures, and risk frameworks for trading positions at Daiwa Securities SMBC and its subsidiaries. Moreover, a system has been set up to monitor whether measured risk is not exceeding the upper-limit established for the trading departments and to make reports to management. Daily and monthly reports regarding market risk and credit risk related to trading positions are made to the management. Comprehensive quarterly reports, which include other risk information, are submitted to the Risk Management Committee.

In addition, Daiwa Securities SMBC Europe has built an independent risk management system based on local laws and regulations. Reports on market risk and credit risk related to trading positions are made regularly to the local management, as well as to the Risk Management Department at Daiwa Securities SMBC.

A similar risk management system has been put in place at Daiwa America Corporation. It makes reports regarding the risk condition to the local management and Daiwa Securities Group Inc.

The management of Daiwa Securities Group Inc. receives daily risk reports on trading positions at the aforementioned subsidiaries via its department in charge of risk management. By means of these reports, the Group's management team obtains an accurate grasp of the risk profiles of its trading positions.

In addition, comprehensive and exhaustive quarterly reports are made to the Internal Control Committee regarding market and credit risks for financial assets other than trading positions.

Based on these daily, monthly, and quarterly reports, Daiwa Securities Group Inc. monitors whether its subsidiaries' capital, which is the Group's invested capital, is being exposed to excessive risk.

(2) Measures for Dealing with Major Risks

[Market Risk]

Market risk is the risk of incurring losses resulting from fluctuations in the value of financial assets or liabilities due to changes in stock prices, interest rates, exchange rates, and value of derivative products. The Group's trading positions are mainly exposed to market risk.

The Group employs Value at Risk (VaR), a commonly used statistical management method, as an index for measuring and monitoring the market risk of its trading positions. VaR provides an estimate of losses that will be incurred from a trading position over a certain period and at a certain confidence level. The Group uses a holding period of one day and a confidence level of 99%. This is equivalent to the probability that losses could exceed those indicated by the VaR method, one day out of 100 days of actual trading.

Value at Risk

[Range and Assumption of VaR]

• Confidence level: 99% • Holding period: 1 day • Adjusted for price correlation between products

Daiwa Securities SMBC (Non-consolidated)

(Billions of yen)

(Month end)	3/04	9/04	3/05	6/05	9/05	12/05	3/06
Equity	0.52	0.98	1.77	0.71	1.03	0.50	1.87
Interest	0.54	0.93	0.35	0.31	1.15	0.57	0.80
Currency	0.05	0.07	0.06	0.08	0.08	0.24	0.11
Total	1.11	1.98	2.18	1.10	2.26	1.31	2.78
Diversification effect	-0.36	-0.39	-0.37	-0.33	-0.58	-0.39	-0.96
VaR	0.75	1.59	1.81	0.77	1.68	0.92	1.82
Quarterly							
High	1.57	2.90	5.98	2.19	1.87	1.69	2.68
Low	0.71	0.75	0.60	0.77	0.66	0.92	0.84
Average	1.03	1.76	1.31	1.47	0.96	1.31	1.35

The Daiwa Securities Group (Consolidated)

(Billions of yen)

(Month end)	3/05	6/05	9/05	12/05	3/06
Equity	1.86	0.77	1.09	0.53	1.93
Interest	0.52	0.48	1.29	0.78	0.92
Currency	0.06	0.08	0.08	0.24	0.11
Total	2.44	1.33	2.46	1.55	2.96
Diversification effect	-0.40	-0.38	-0.60	-0.40	-0.98
VaR	2.04	0.95	1.86	1.15	1.98
Quarterly					
High	6.21	2.39	2.30	1.95	3.07
Low	0.78	0.95	0.81	1.15	0.99
Average	1.58	1.66	1.19	1.55	1.56

The Group uses numerous assumptions when measuring VaR and believes that such assumptions are rational and appropriate. However, different assumptions can cause major changes in VaR measurements. In addition, the usefulness of VaR is limited in the following ways.

- Past market fluctuations do not necessarily provide an accurate guide for future market movements.
- Actual market price fluctuations of a trading position can differ from the result produced by the VaR model, due to changing market conditions.
- VaR based on one-day holding periods does not sufficiently account for market risk affecting positions that cannot be liquidated or hedged in one day.
- The reliability of VaR declines when actual market conditions differ from those seen during the period in which data was collected.

The above factors highlight the limitations of VaR. For this reason, the Group adopts comprehensive risk management using various techniques in addition to VaR, such as stress testing and scenario analysis. The Group also undertakes risk monitoring and control according to the respective levels at the trading desk and the departments and companies involved.

[Market Risks Unrelated to Trading Positions]

The Group also holds investment securities that are unrelated to trading positions but nonetheless are exposed to market risks. These include investment securities held from a long-term perspective for business relationship purposes, and private equity and other securities related to the venture capital business and the principal investment business. Quarterly reports on the balance of holdings of such securities are made to the Internal Control Committee as an indication of investment risk, which reflects the level of market risk. A system has been set up to measure VaR for listed stocks included in these securities and to make reports.

[Credit Risk]

Credit risk is the risk of losses sustained as a result of clients being unable to repay debts according to contract.

In its wholesale securities business, the Group limits exposure to credit risk by setting credit limits for each counter party. The Group also assigns clients internal ratings, similar to those given by external rating agencies. These internal ratings serve as a standard for judging whether or not to execute transactions with a counter party. The usage of these credit limits is monitored regularly.

Furthermore, the Group manages credit risk associated with its wholesale securities business by regularly reviewing the financial situation of each counter party, having them all sign comprehensive netting contracts, securing collateral, and limiting the periods of transactions.

[Liquidity Risk]

Liquidity risk is the risk that the Group will run into difficulty procuring funds, or that the cost of procurement will rise significantly higher than normal, as a result of changes in the market environment or a deterioration in the balance sheet.

The Group carries out its business activities using many assets, the majority of which are highly liquid, and liabilities. As for the latter, the Group endeavors to employ diversified procurement methods and multiple maturity periods in order to minimize the risks associated with refinancing. In addition to straight bonds, convertible bonds, and medium-term note programs, the Group procures funds mainly through borrowing from financial institutions, issuing commercial paper, call money, and repurchase agreements and transactions.

The amount and cost of funds raised are influenced by market conditions and the Group's credit rating. The Group believes it is important to have an appropriate asset-liability balance and to maintain and manage liquidity.

To ensure that business activities are not interrupted, even in the event of a credit crunch stemming from large fluctuations in financial markets, the Group believes it is important to maintain sufficient liquidity to allow it to meet its funding needs for about one year, without relying on new uncollateralized fund procurement. As of March 31, 2006, the Group had a liquid portfolio totaling ¥1,181.8 billion, consisting mainly of cash and deposits, government bonds, and other highly negotiable instruments.

As for management of liquidity, to minimize liquidity risk in the event of deteriorating market conditions and lower procurement costs, the Group has introduced a group cash management system (group CMS) to procure and centrally manage funds for the entire Group, including funds needed to cover the business activities of Daiwa Securities Group Inc. and its subsidiaries. However, some of these subsidiaries carry out their own fund procurement and management activities. This applies to securities companies, because procurement is a part of the securities business, and to listed subsidiaries (NIF SMBC Ventures), which are required to procure funds independently from the parent company. Daiwa Securities Group Inc. continuously monitors the fund-raising plans and activities of these subsidiaries as part of the group CMS. Other subsidiaries, however, integrate their fund procurement with that of the parent company under the group CMS.

[Operational Risk]

Operational risk is the risk of incurring losses due to inappropriate or malfunctioning internal processes, personnel, or computer systems, or due to adverse external occurrences.

As the Group's business becomes more sophisticated, diversified, and systemized, the accompanying risks become more varied, and the need to manage such operational risk grows each year.

Specialized sections have been set up in each company to address operational risk, and conferences are held to consider necessary issues.

Due to the diversifying nature of its business, the Group sets rigid rules concerning authority, automates office-work processes to reduce human error, prepares business manuals, and takes other necessary measures. Each Group company strives to reduce operational risk according to the nature of its own business.

[System Risk]

One form of operational risk is system risk, which refers to the potential for incurring losses due to computer breakdown or malfunction or other system-related inadequacies. It also covers the risk of losses caused by leakage of information or improper use of computers.

The Group has established an information security policy, centering on system risk management, aimed at mitigating these types of risk. To implement this policy, the Group has set security standards (regulations related to information security) and works to ensure that executives and employees are well versed and fully compliant with those standards.

In addition, the Group constantly monitors the operating status of its core systems to keep disorders to an absolute minimum. Even if problems do occur, the Group has frameworks in place to respond to them swiftly.

[Legal Risk]

Legal risk refers to the potential for incurring losses due to non-compliance with legal and other regulations, lawsuits, invalid contracts with third parties, or violations of corporate ethics rules.

The Group pursues group management with securities-related activities as its core business. Here, there are laws and regulations that must be observed when executing securities transactions, and in general businesses outside of the securities business. The Group is also required to comply with various regulations.

To ensure against infringement of these regulations, the Group has set up sections in charge of compliance at each company, and has established committees to discuss and decide on compliance issues and matters related to corporate ethics.

Securities transactions and other third-party agreements often require high levels of specialization to determine the legality of contracts and suitability of processes. In response to such cases, the Group has consulting agreements with law firms, including overseas firms, to obtain legal advice.

[Reputation Risk]

Reputation risk refers to the possibility of the Group sustaining unforeseen losses due to deterioration of its reputation stemming from the spread of rumors or erroneous economic information. There are no uniform procedures for managing reputation risk, because it can emanate from a variety of sources.

The Group has established various regulations based on its Disclosure Policy, with particular emphasis on the management and provision of information. It has also set up the Disclosure Committee within Daiwa Securities Group Inc.

Each group company is charged with the task of reporting information containing reputation risk to the Disclosure Committee. Information is obtained and centrally managed at Daiwa Securities Group Inc., which disseminates it in a timely and accurate manner according to resolution of the Disclosure Committee.

The Group works hard to keep abreast of problems and occurrences that may affect its reputation, so that when problems do occur their impact on the Group can be minimized. The Group also acts to ensure that erroneous and inaccurate information is properly corrected. To enable appropriate response to libel and other issues, the Group has public relations and investor relations systems in place to prevent and minimize risks to its reputation.

The Daiwa Securities Group's Credit Ratings

(As of June 30, 2006)

	Daiwa Securities Group Inc.		Daiwa Securities		Daiwa Securities SMBC	
	Long-term	Short-term	Long-term	Short-term	Long-term	Short-term
Moody's	Baa1	—	Baa1	P-2	A2	P-1
Standard & Poor's	BBB+	A-2	BBB+	A-2	A-	A-2
Rating and Investment Information (R&I)	A-	a-1	A-	a-1	A	a-1
Japan Credit Rating Agency (JCR)	A	—	A	—	—	—