

## Group Governance and Management Systems

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## Corporate Governance

The Daiwa Securities Group is committed to creating a highly transparent and objective corporate governance system consistent with international standards. We clearly separate the supervisory and executive functions of management, and maximize each Group company's efficiency and expertise while establishing a Group management structure that highlights synergies between the Group companies.

### Features of the Corporate Governance System

In 1999, the Daiwa Securities Group became the first listed Japanese company to adopt a holding company structure. Since then, we have been pursuing a highly transparent and objective corporate governance framework that maximizes synergy between Group companies while showcasing the independence and unique expertise of each Group member.

In June 2004, the Group made the transition to a "committee system" of corporate governance and accelerated the decision-making process by transferring a substantial portion of authority from the Board of Directors to the executive officers. In addition, we strengthened the supervisory functions of management by increasing the number of outside directors and establishing the Nominating, Audit, and Compensation Committees. The representative directors of major Group companies also serve as executive officers of the holding company, allowing them to efficiently implement individual business strategies based on Group strategies.

The Nominating Committee met three times in FY 2006 to further discuss the composition of the Board of Directors and its effect on corporate governance, the basic policy for nominating candidates for directorships, and the selection of these candidates. The Nominating Committee selects candidates for directorships in light of the Group's standards for the appointment of directors. These standards include criteria that help ensure the independence of outside directors.

The Audit Committee met 12 times in FY 2006 to audit the activities of directors and executive officers, focusing on their progress in implementing internal control systems.

The Compensation Committee met five times in FY 2006 to discuss compensation policy and determine the compensation of each director, and also studied a Group-wide incentive plan aimed at improving consolidated earnings results.

The Board of Directors met 12 times in FY 2006, with 96% attendance of the four outside directors.

### Executive Compensation Linked to Performance

Compensation for directors and executive officers is determined by the Compensation Committee. It has three components: basic compensation, performance-based compensation, and stock-price-linked compensation. Criteria used in calculating performance-based compensation include financial results, such as consolidated ordinary income and ROE, as well as operating assets and indicators of customer satisfaction and productivity. We discontinued the retirement benefit system for directors at Daiwa Securities Group Inc., Daiwa Securities, and Daiwa Securities SMBC to strengthen the correlation with performance and to enhance the transparency of executive compensation.

### Compensation Paid to Directors and Executive Officers in FY 2006

|   | Directors  |              | Executive officers |                | Total      |                |
|---|------------|--------------|--------------------|----------------|------------|----------------|
|   | Recipients | Amount       | Recipients         | Amount         | Recipients | Amount         |
| Amounts based on resolution of the Compensation Committee | 5 persons  | ¥105 million | 14 persons         | ¥1,042 million | 19 persons | ¥1,147 million |

Notes: 1. The above compensation amounts include performance-linked pay to reflect FY 2006 earnings.

2. The above compensation amounts include a total of ¥100 million in stock acquisition rights granted as stock options to directors and executive officers.

3. In addition to the above, ¥19 million in retirement benefits were paid to one director who retired from the Board of Directors in FY 2006, pursuant to a resolution of the 67<sup>th</sup> Ordinary General Meeting of Shareholders held on June 23, 2004.

4. Of the total compensation amount of ¥1,147 million, compensation paid to the four outside directors totaled ¥67 million.

5. As of March 31, 2007, there were 13 directors and 14 executive officers. Eight of the directors also served as executive officers (their total compensation is included in the "Executive officers" category).

### Internal Control System

The Daiwa Securities Group defines “internal control” as a collection of processes aimed at promoting business effectiveness, efficiency, reliable financial reporting, compliance with laws related to business activities, and asset preservation. The Group is building an extensive internal control system to ensure that these processes function effectively and efficiently.

Internal auditing departments have been established at major Group companies to carry out internal audits. In addition, the Internal Audit Department, which is under the direct control of the CEO of Daiwa Securities Group Inc., audits Group companies that do not have their own internal auditing departments.

The internal auditing departments, including that of Daiwa Securities Group Inc., undertake regular audits based on predetermined auditing plans, and verify the status of internal control activities. The frequency and extent of audits are determined on a case-by-case basis, following an evaluation of risks and other factors. The Internal Audit Department regularly communicates with the internal auditing departments of major Group companies, and thereby coordinates efforts to upgrade the Group’s internal control and internal auditing systems.

In the case of Daiwa Securities Group Inc., internal auditing plans and the results of internal audits are reported to and approved by the Internal Control Committee, a subcommittee of the Executive Committee. The auditing plans and results for major Group companies are reported to and approved by committees such as the Legal Affairs and Compliance Committee. The Internal Audit Department also reports the results of internal audits to the Audit Committee.

The Audit Committee conducts audits in collaboration with the Internal Audit Department and, when necessary, can ask the Internal Audit Department to research the items required to conduct the audits.

The Group is also engaged in efforts to introduce internal control for financial reporting, in response to the internal control reporting requirements introduced as part of the Financial Instruments and Exchange Law. To prepare to comply with these requirements in FY 2008, we have set up four working groups, to deal with Group-wide control, overall IT control, operating processes and verification. These groups are documenting processes throughout the Group, and assessing and verifying internal controls. We will make additional improvements to organizational structures or internal regulations where necessary.

## Top Management

### Directors

*Chairman of the Board*

**Yoshinari Hara**

*Deputy Chairman of the Board*

**Akira Kiyota**

*Directors*

**Shigeharu Suzuki**

**Shin Yoshidome**

**Tetsuo Mae**

**Takashi Hibino**

**Ikuo Mori**

**Nobuyuki Iwamoto**

**Kenji Hayashibe**

**Tetsuro Kawakami**

**Ryuji Yasuda**

**Keisuke Kitajima**

**Koichi Uno**

### Executive Officers



1971 Joined Daiwa Securities Co. Ltd.  
1997 Director, Chief Corporate Institutions Officer  
1998 Managing Director  
1999 Managing Director, Daiwa Securities Group Inc.  
2001 Senior Managing Director  
2002 Senior Managing Director, Daiwa Securities SMBC Co. Ltd.  
2003 Representative Senior Managing Director  
2004 Director, President and CEO,  
Daiwa Securities Group Inc. (to present)  
Head of Retail (to present)  
President, Daiwa Securities Co. Ltd. (to present)



1974 Joined Daiwa Securities Co. Ltd.  
1997 Head of Osaka Branch Corporate Institutions Dept. I  
2001 Executive Officer, Daiwa Securities SMBC Co. Ltd.  
2004 Senior Executive Officer  
Managing Director  
2006 Director and Corporate Executive Vice President,  
Daiwa Securities Group Inc.  
Representative Senior Managing Director,  
Daiwa Securities SMBC Co. Ltd.  
2007 Director, Deputy President and COO,  
Daiwa Securities Group Inc. (to present)  
Head of Wholesale (to present)  
President, Daiwa Securities SMBC Co. Ltd. (to present)



1969 Joined Daiwa Securities Co. Ltd.  
1996 Director, Head of Corporate Institutional Sales Division  
1998 Managing Director  
1999 Managing Director, Daiwa Securities Co. Ltd.  
2000 Senior Managing Director  
2003 Deputy President, Daiwa Securities Co. Ltd. (to present)  
2004 Director and Deputy President,  
Daiwa Securities Group Inc. (to present)  
Deputy Head of Retail (to present)



1972 Joined The Sumitomo Bank, Limited  
1997 Head of Hong Kong Branch  
1999 Executive Officer  
2001 Executive Officer (Director),  
Sumitomo Mitsui Banking Corporation  
2003 Executive Officer (Managing Director)  
2006 Representative Director and Senior Managing Director  
2007 Deputy President, Daiwa Securities Group Inc. (to present)  
Deputy Head of Wholesale (to present)  
Deputy President, Daiwa Securities SMBC Co. Ltd.  
(to present)



1969 Joined Daiwa Securities Co. Ltd.  
1995 Director  
1998 Managing Director  
1999 Managing Director, Daiwa SBCM Co. Ltd.  
(currently Daiwa Securities SMBC Co. Ltd.)  
2000 Senior Managing Director  
2002 Representative Senior Managing Director  
2004 Director and Deputy President,  
Daiwa Securities Group Inc.  
Deputy President, Daiwa Securities SMBC Co. Ltd.  
2005 Deputy President, Daiwa Securities Group Inc. (to present)  
Head of Asset Management (to present)  
President, Daiwa Asset Management Co. Ltd. (to present)



1968 Joined Daiwa Securities Co. Ltd.  
1993 Director  
1997 Managing Director  
1999 Senior Managing Director, Daiwa SBCM Co. Ltd.  
(currently Daiwa Securities SMBC Co. Ltd.)  
2001 Deputy President  
2002 Deputy President, Daiwa Securities Group Inc.  
2003 Deputy President and Chairman of the Institute,  
Daiwa Institute of Research Ltd.  
2004 Deputy President, Daiwa Securities Group Inc. (to present)  
Head of Research (to present)  
President, Daiwa Institute of Research Ltd. (to present)



*Corporate Executive Vice President  
Chief Planning/Personnel Officer*

**Takashi Hibino**

1979 Joined Daiwa Securities Co. Ltd.  
2002 Head of Corporate Planning Department, Daiwa Securities Group Inc.  
Executive Officer, Daiwa Securities SMBC Co. Ltd.  
2004 Senior Executive Officer, Daiwa Securities Group Inc.  
Chief Planning/Personnel Officer (to present)  
Director and Corporate Senior Executive Officer  
2007 Director and Corporate Executive Vice President, Daiwa Securities Group Inc. (to present)



*Corporate Executive Vice President  
Deputy Head of Wholesale Representative Senior Managing Director, Daiwa Securities SMBC Co. Ltd.*

**Ikuo Mori**

1973 Joined Daiwa Securities Co. Ltd.  
1996 President, Daiwa Securities America Inc.  
2001 Executive Officer, Daiwa Securities Group Inc.  
2004 Corporate Executive Officer  
2005 Corporate Senior Executive Officer  
2006 Managing Director, Daiwa Securities SMBC Co. Ltd.  
2007 Director and Corporate Executive Vice President, Daiwa Securities Group Inc. (to present)  
Deputy Head of Wholesale (to present)  
Representative Senior Managing Director, Daiwa Securities SMBC Co. Ltd. (to present)



*Corporate Senior Executive Officer and CIO  
Director (part-time), Daiwa Institute of Research Ltd.*

**Akira Nakamura**

1983 Joined Daiwa Securities Co. Ltd.  
1996 Head of System Solutions Department I, Daiwa Institute of Research Ltd.  
1999 Executive Officer  
2003 Senior Executive Officer  
2005 Managing Director  
2006 Corporate Senior Executive Officer and CIO, Daiwa Securities Group Inc. (to present)  
Director (part-time), Daiwa Institute of Research Ltd. (to present)



*Corporate Executive Officer and CFO  
Director (part-time), Daiwa Asset Management Co. Ltd.*

**Nobuyuki Iwamoto**

1980 Joined Daiwa Securities Co. Ltd.  
2001 Head of International Finance Department, Daiwa Securities SMBC Co. Ltd.  
2005 Corporate Executive Officer and CFO, Daiwa Securities Group Inc. (to present)  
Director (part-time), Daiwa Asset Management Co. Ltd. (to present)  
2006 Director, Daiwa Securities Group Inc. (to present)



*Corporate Executive Officer  
Head of America Region  
Chairman, Daiwa America Corporation*

**Masamichi Yokoi**

1975 Joined Daiwa Securities Co. Ltd.  
2001 President, Daiwa Securities SMBC Europe Limited  
2006 Corporate Executive Officer, Daiwa Securities Group Inc. (to present)  
Head of America Region (to present)  
Chairman, Daiwa America Corporation (to present)



*Corporate Executive Officer  
Deputy Chief Planning/Personnel Officer  
Head of Corporate Planning Department*

**Seiji Nakata**

1983 Joined Daiwa Securities Co. Ltd.  
2005 Head of Structured Products Department, Daiwa Securities SMBC Co. Ltd.  
2006 Executive Officer  
2007 Corporate Executive Officer, Daiwa Securities Group Inc. (to present)  
Deputy Chief Planning/Personnel Officer (to present)  
Head of Corporate Planning Department (to present)



*Corporate Executive Officer  
Chief Legal Officer  
Head of Corporate Communications Department*

**Masaaki Goto**

1982 Joined Daiwa Securities Co. Ltd.  
2005 Head of Structured Finance Department, Daiwa Securities SMBC Co. Ltd.  
2007 Corporate Executive Officer, Daiwa Securities Group Inc. (to present)  
Chief Legal Officer (to present)  
Head of Corporate Communications Department (to present)



*Corporate Executive Officer*

**Yoshinari Hara**

1967 Joined Daiwa Securities Co. Ltd.  
1991 Director, Deputy Head of Corporate Institutional Sales Division  
1995 Managing Director  
1997 Representative Managing Director  
President  
1999 President and CEO, Daiwa Securities Group Inc.  
President, Daiwa Securities Co. Ltd.  
2004 Chairman of the Board and Corporate Executive Officer, Daiwa Securities Group Inc. (to present)



*Corporate Executive Officer  
Chairman of the Institute and Director, Daiwa Institute of Research Ltd.*

**Akira Kiyota**

1969 Joined Daiwa Securities Co. Ltd.  
1994 Director, Deputy Head of Sales Division, and Head of East Division  
1997 Managing Director  
Representative Managing Director  
Deputy President  
1999 President, Daiwa SBCM Co. Ltd. (currently Daiwa Securities SMBC Co. Ltd.)  
2004 Deputy Chairman of the Board and Corporate Executive Officer, Daiwa Securities Group Inc. (to present)  
Chairman of the Institute, Daiwa Institute of Research Ltd. (to present)  
2005 Director, Daiwa Institute of Research Ltd. (to present)

## Human Resource Management

The Daiwa Securities Group derives much of its competitive strength from its personnel. To maximize competitiveness, the Group fosters an environment in which all employees are motivated to enhance their abilities and realize their full potential. We actively encourage employees to upgrade their skills, and we are striving to establish a personnel management system that can evaluate employee performance more accurately.

### Group Personnel Policy

The Daiwa Securities Group is keenly aware of the importance of our employees, who are the wellspring of the Group's competitiveness. Our stated policy is to "emphasize the creativity of each employee, foster a free and vigorous corporate culture filled with the spirit of challenge, and accurately evaluate the performance and contributions of employees." It is employees who supply the effort and inspiration needed to elevate shareholder value. Therefore, one of the best ways for a company to improve the satisfaction of its investors and customers is to seek out optimal systems and methods for motivating employees.

#### Advanced Evaluation System and Performance-based Remuneration

The Daiwa Securities Group adheres strictly to results- and performance-oriented standards of evaluation, in order to ensure that its personnel system is fair and objective. The Group uses a two-way evaluation system, in which superiors and subordinates evaluate one another, as well as a multi-directional evaluation system, in which employees are evaluated by other closely related divisions and Group companies, based on objective criteria. We also conduct "evaluator training" programs to enhance the evaluation skills of employees. In accordance with the Group's fair evaluation policy, Daiwa Securities has established the "President's Awards," which are awarded twice a year in an effort to further motivate employees. Similar awards programs have been introduced at Daiwa Securities Group Inc. and Daiwa Securities SMBC.

The Group has adopted an employee remuneration system that is based on job category as well as performance appraisal using a detailed, job-specific evaluation process. At the deputy general manager level, there was a 20-fold disparity between the smallest and the largest bonus paid in FY 2006, and a five-fold difference in their annual salaries. Performance-based remuneration systems were also introduced for analysts at Daiwa Institute of Research and fund managers at Daiwa Asset Management, in which annual salaries are determined to reflect analyst rankings or fund performance.

#### Skill Enhancement Opportunities and Career Development Options for Employees

The Daiwa Securities Group continues to upgrade personnel support systems which encourage employees to enhance their skills and obtain qualifications, particularly certifications related to

financial services, such as financial analyst or financial planner. We also provide career development training to cultivate administrative and business leaders. In FY 2008, the Group plans to introduce a career advancement system based on employees' qualifications, on a full scale. Under this system, employees must earn a specified number of "qualification points" in order to receive promotion to a given job level. Points are awarded when the employee meets certain certification-based criteria; for example, when they obtain accreditation as a financial analyst or other qualifications that are useful in the securities industry. The number of points awarded increases relative to the difficulty of earning the particular qualification. This system provides employees with greater incentives to enhance their abilities.

In addition, we have adopted an intra-Group job posting system, which allows employees to embrace new challenges by moving to a department of their choice within the Group. Since its introduction in 2000, the system has attracted 648 applicants, 123 of whom have successfully qualified for transfers.

### Human Resource Initiatives Under the Medium-term Management Plan

The Group's basic human resources policy, as spelled out in the medium-term management plan, is "to attract the most competent personnel in the industry and provide them with highly motivating working environments that allow them to pursue new challenges." There are five main elements of this policy: (1) Establish compensation standards and systems which rank among the best in the industry, in order to attract and keep top-quality employees and contribute to improved corporate performance; (2) Develop an ongoing program of recruitment to attract talented and loyal employees, promoting communication with students and raising the Daiwa Securities Group's profile as an attractive career option for new graduates; (3) Carry out training programs to cultivate the industry's most highly specialized team of financial professionals; (4) Maintain a stimulating working environment for all employees, regardless of gender, and thereby seek to elevate the morale and tap the latent potential of female employees in particular. We will make ongoing efforts to ensure that our workplaces cater to the particular needs of women; and (5) Promote a work environment that rewards employees equally for equivalent contributions,

regardless of their age, thus ensuring that the Group can fully benefit from the extensive experience of veteran employees.

Over the three years covered by the plan, the Daiwa Securities Group intends to increase its domestic workforce by around 2,000 employees.

### Corporate Activation Plan

In July 2006, the Daiwa Securities Group announced its “Corporate Activation Plan,” under the slogan: “promoting passion, pride and job satisfaction to make Daiwa Japan’s best securities group.” Additional measures under the plan were announced in March 2007. In conjunction with the medium-term management plan, this initiative aims to promote a corporate environment that will stimulate and motivate employees. The goal is to give each employee who works for the Daiwa Securities Group a strong feeling of trust in their company, a sense of pride in their work responsibilities and contributions, and a feeling of solidarity with the Daiwa Securities Group and its members. A number of individual programs have been implemented as part of this plan.

### Mental Health Care Support

In August 2006, Daiwa Securities Group Inc. established a Mental Health Support Department. This department provides confidential consultation services to employees who are experiencing anxiety, listlessness, insecurity or stress, in an effort to support the mental health of all Group personnel.

### Support for Working Mothers

For many years, the Daiwa Securities Group has taken an active role in supporting working women. The Group has established a “Women’s Advancement Action Team” within its Personnel Department, which introduced a “Support Plan for Working Mothers,” and has taken a variety of other steps to help employees balance the demands of their job and their family. The Group continues to actively recruit female employees and encourage their contributions. Not only is the number of women rising year by year, but the Group is actively promoting them into managerial positions.

In recognition of these efforts, the Ministry of Health, Labour and Welfare recognized the Daiwa Securities Group in June 2006 at its “Corporation Award for the Promotion of Gender Equality 2006,” presenting the Director of Tokyo Labour Bureau Award to three Group companies—Daiwa Securities Group Inc., Daiwa Securities, and Daiwa Securities SMBC. During FY 2006, the Group continued to pursue measures to promote a better environment for working women. For example, we issued the “Guide to Parenting Support,” which explains the Group’s systems for helping employees with children. We will continue to explore positive measures that the Group can implement in order to create a comfortable working environment for both men and women.

### Increase in Base Wage for New Employees

In the spring of 2007, as part of its effort to attract top quality personnel, the Group increased its basic starting salary for new graduates from ¥178,000 to ¥200,000 per month. This is the first base salary hike since 1994.

### Promotion of Temporary Staff to Permanent Employee Status

The Daiwa Securities Group has instituted a program under which temporary workers who have been employed for a specified period of time, demonstrating loyalty and making positive contributions to the Group, are offered the opportunity to enhance their careers by passing an examination and becoming permanent employees. The Group plans to conduct these reviews of qualifying temporary staff periodically, over the coming years.

### Other Initiatives in FY 2006 and Beyond

#### Support and Employment for Veteran Personnel

In the past, the Daiwa Securities Group has often rehired employees after their official date of retirement, under the “Daiwa Elderly Support System.” In addition, the Group responded to the government’s “Revised Law for the Stabilization of Employment of the Aged” implemented in April 2006, by introducing the “Daiwa Master System” (also in April) for re-hiring retirees. We will actively employ individuals who show the desire and ability to contribute, regardless of their age, and continue to make active use of the skills and experience of veteran employees.

#### Adherence to Equal Employment Opportunity Law

With the introduction of a revised “Equal Employment Opportunity Law,” the Daiwa Securities Group took further steps to strengthen internal policies to prevent sexual harassment and discrimination. The Group already has internal regulations forbidding all forms of sexual harassment, and has set up a “Corporate Ethics Hotline” and other structures for reporting and discussing problems of this sort. However, we have additionally provided clear guidelines on the actions which might constitute harassment, and clearly stated in our employment regulations that we will ensure confidentiality, protect the privacy of the aggrieved or worried parties and make sure that they suffer no subsequent disadvantages for reporting the offense. Through these measures, the Group is constantly considering ways to ensure a positive and comfortable working environment.

#### Implementation of “Cool Biz”

We are eager to do our part to prevent global warming, and have implemented “Cool Biz”<sup>\*</sup> since the summer of 2007 at Daiwa Securities Group Inc., Daiwa Securities, and Daiwa Securities SMBC, in addition to other group companies where the project had already been initiated.

<sup>\*</sup> Summer business norms promoted by the government of Japan, encouraging people to wear cool and comfortable clothes at the office, and set air-conditioning at 28 degrees Celsius to save energy and reduce CO<sub>2</sub> emissions.



## Financial Strategy

In order to perpetuate growth in corporate value, the Daiwa Securities Group manages risk, returns, and capital in an integrated manner. Our policy is to build a break-even structure that is resistant to revenue fluctuations, and to manage risk in a way that protects our highly stable financial position. We will endeavor to maximize risk-adjusted returns by efficiently allocating capital resources.

### Targeting Financial Stability

In order to maintain its financial stability, the Group carefully manages the major risks affecting its consolidated balance sheet, including market risk, credit risk, and liquidity risk. This approach allows us to maintain a firm financial base, which can absorb potential losses due to dramatic changes in the business environment. In this way, the Group can maintain a stable business foundation.

Regarding market risk, the Group manages the upper limit against trading positions and Value at Risk (VaR: expected value of maximum loss at more than 99% confidence level). In addition, theoretical scenarios of market stress are used to estimate the potential scale of losses which could occur due to significant changes in business conditions.

With regard to credit risk, the Group sets credit limits, and carefully examines the risk involved in large-scale, low-liquidity investments such as principal investments, a business which we are actively expanding. In the process, risk concentration is given full consideration. The Group carefully monitors its investments after they have been made. We look at these risks holistically, not only maintaining the necessary capital required by law, but also ensuring that the total amount of risk is commensurate with capital.

With respect to liquidity, the Group's policy is to maintain enough long-term capital to fully fund business operations for around one year, without relying on new unsecured fund procurement. We also control liquidity by avoiding excessive concentration on specific fund-raising sources or repayment periods.

### Integrated Management of Risk, Return, and Capital

In order to increase corporate value steadily, and meet the growth targets contained in the medium-term management plan, the group manages risk, return, and capital using an integrated approach to maintain profitability and a firm financial position.

#### Capital

Under the medium-term management plan, the Group plans to increase consolidated shareholders' equity to ¥1 trillion, based solely on the inflow from retained earnings after dividends are paid. To accomplish this goal, we allocate capital based on the characteristic features of each business segment, and maintain a certain level of standby capital in preparation for new business development, strategic investment, and M&A.

#### Return

In each business division, the Group seeks to expand consolidated profits and maintain a high ROE, by keeping profitability at levels that surpass the cost of capital. In addition, we intend to improve the balance between revenues and expenditures, increasing both the absolute level and the stability of earnings, while maintaining a balanced level of investment in future growth.

#### Risk

The Group will adopt a more aggressive approach to risk-taking, especially in its wholesale and investment businesses. To address the higher level and complexity of risk that this will generate, the Group will adopt appropriate steps to monitor risk, refine its methods of quantifying risk, and adopt more sophisticated risk assessment methods and risk management techniques.



## Risk Management

As the Daiwa Securities Group pursues profitability and growth, it also recognizes the importance of accurately identifying, evaluating, and effectively controlling the various risks associated with its business operations. Our objective is to improve corporate value steadily, while maintaining a sound financial base and profit structure, properly balancing risks and returns, and anticipating any possible business scenarios that might elevate risk.

### Risk Management System

The Group's risk management policy encourages active participation by top management to ensure that the risks inherent in business operations are comprehensively managed in a manner appropriate to their specific risk attributes. The status of each risk management activity is reported regularly to the Internal Control Committee, a subcommittee of the Executive Committee.

The major risks that affect our businesses are market risk, credit risk, liquidity risk, system risk, operational risk, reputation risk, and legal risk\*.

Leveraging their expertise, each Group subsidiary is responsible for managing the particular risks of their own business. Daiwa Securities Group Inc. is responsible for Group-wide risk management, and monitors the framework, methods, and implementation status of risk management activities undertaken by the subsidiaries. It also tries to maintain a comprehensive vision of risk levels for the Group as a whole, and keep them at levels commensurate with the amount of capital at risk.

\* See "Compliance" on page 68.

### Addressing Financial Risk (Market, Credit, and Liquidity Risks)

The Group sets limits on each type of market risk, and measures and monitors risk in its trading operations, using risk indicators such as Value at Risk (VaR). Our comprehensive risk management approach also employs stress tests and scenario analyses.

Subsidiaries involved in the wholesale securities business have the greatest exposure to credit risk. These companies conduct rigorous credit checks, and decide whether or not to execute transactions or request collateral. Internal credit ratings and credit limits are set for each client, based on these investigations and the transaction period, and are monitored continuously.

To address liquidity risk, the Group maintains an ample supply of liquid capital and manages the maturity schedule of its liabilities portfolio, with the aim of maintaining sufficient funds to support business operations for around one year, without the need for new uncollateralized fund procurement. The liquidity of Group subsidiaries—excluding securities subsidiaries and NIF SMBC Ventures, a JASDAQ-listed company—is centrally managed by the Group Cash Management System of Daiwa Securities Group Inc.

Information on market risk is reported daily, and credit risk conditions are reported monthly to the management of Daiwa Securities Group Inc. However, if clients exceed their credit limits or have their credit status changed, additional reports may be provided, as necessary. Liquidity risk is reported daily.

### Addressing Operational Risk and Systems Risk

The Group is giving priority consideration to the risks that arise when personnel act inappropriately or ineffectively, when internal processes and computer systems malfunction, and when external events affect operations. Due to the diversity of our business operations, we are implementing a number of key measures, such as establishing stricter lines of authority, automating business processes to reduce human error, and preparing administrative manuals. We are also working to quantify operational risk more precisely.

The Group constantly monitors the operating status of its core operating systems to keep malfunctions to an absolute minimum. Even if problems do occur, the Group has frameworks in place to respond quickly.

The Group is also taking steps to establish a business continuity plan (BCP). In FY 2006, we prepared a manual for addressing system failures. We are now refining our emergency response manuals, and plan to transfer our backup system to a new data center that is capable of withstanding natural disasters. This is expected to significantly improve systems safety.

## Compliance

The Daiwa Securities Group views compliance as more than simply a system to ensure that the Group “complies with laws and regulations.” Rather, compliance refers to our ongoing effort to earn the trust of customers, the market, and society, and thus fulfill the first and foremost of our corporate principles of “building trust.” Therefore, our compliance activities include efforts to educate and condition every executive and employee to constantly consider the impact of their activities, and to act in a manner that will promote trust and confidence in the Daiwa Securities Group.

### Group Compliance Initiatives and Structures

The General Affairs department of Daiwa Securities Group Inc., which oversees the compliance activities of Group companies, organizes a “General Affairs/Corporate Ethics Promotion Liaison Meeting” once a month. Members of the meeting include representatives from departments responsible for compliance in each Group company. This meeting is intended to share information on compliance and other issues that Group members should address, and ensure that the information is clearly understood by all Group companies. The meeting also periodically takes steps to ensure that the influence of corporate racketeers and other antisocial groups has been eliminated, and monitors the compliance structure of each Group company.

In FY 2006, the Group’s Corporate Ethics Officer adopted a more direct approach to training employees. Joint Compliance Training sessions were held for all staff at Daiwa Securities’ branch offices. The Corporate Ethics Officer gave lectures on corporate ethics and the functions of the Group’s internal reporting system—the Corporate Ethics Hotline. The Group also implemented similar training programs for internal administration supervisors at Daiwa Securities SMBC and the head of each department at Daiwa Asset Management.

In addition to the training programs mentioned above, we have introduced the Corporate Ethics Hotline in the Group’s internal newsletter, upgraded the Hotline’s website, and provided direct links to the Hotline on all intranet sites operated by Group companies to ensure that everyone in the Group is aware of the system. Thanks to these efforts, the Hotline has gained higher recognition and reliability, and the number of reports handled by the Hotline is steadily rising. This shows that the Group’s ability to identify and correct illegal acts has improved significantly.

During FY 2006, the Group also implemented an “e-learning program” to educate executives and employees at all Group companies about insider trading. We explained the guidelines for making appropriate securities transactions as a member of a securities group, and ensured that laws and internal guidelines are thoroughly understood.

### Initiatives by Major Group Companies in FY 2006

One of Daiwa Securities’ stated objectives for FY 2006 was “to maximize client trust.” In order to achieve this goal, the company took steps to enhance the quality of sales activities, reject investors with illegitimate motives, improve the quality of administrative activities and strengthen internal controls in an effort to make compliance functions more effective.

Daiwa Securities SMBC identified legal compliance and the establishment of a strict internal control structure as one of the most important issues for management to address. The company formulated a detailed compliance strategy, and implemented an action plan to support its compliance program. During FY 2006, the company conducted an internal inspection based on the “Comprehensive Guidelines for Supervision of Securities Companies,” issued by the Financial Services Agency, established an operational risk management structure, and introduced detailed training programs to ensure that employees have a thorough understanding of these issues. In FY 2007, the full implementation of the Financial Instruments and Exchange Law and revisions to the Law on Sales of Financial Products will bring further changes to the legal and regulatory environment surrounding securities companies. The Daiwa Securities Group will continue to develop and reform its compliance structure to properly address these changes.

The Financial Services Agency took administrative action against Daiwa Securities in December 2006, based on concerns about not preventing unfair trading and other irregularities at the Himeji branch. In response, Daiwa Securities submitted a business improvement plan to the Financial Services Agency in January 2007. We take these incidents very seriously, and are implementing comprehensive measures to enforce compliance and internal control throughout the Group.

## IT Strategy and Information Security

The Daiwa Securities Group is investing aggressively in new information technology (IT), in order to respond effectively to the demands of a rapidly changing and diversifying securities industry. Since we view internal data, including information on individual clients, as an important management resource, the Group has implemented thorough policies to protect such information from the risk of being misused either inside or outside the Group. By maintaining a high-level information security management system, the Group is fulfilling its responsibility to protect internal information, and increasing corporate value.

### IT Strategy

The Daiwa Securities Group actively employs IT systems which allow the Group to respond effectively to a rapidly diversifying and increasingly sophisticated securities business. The Group's core IT strategy is a central element of its overall business strategy, and includes plans to enhance Daiwa Securities' online trading business and improve the equity and bond trading systems at Daiwa Securities SMBC. In order for the IT services operations of the Group to fully support the IT needs of the securities business, it is essential to attract and train high-quality personnel with very specialized IT skills. The Group is making a full effort to cultivate these important employees.

### IT Organization

Although it is investing aggressively in IT infrastructure, the Daiwa Securities Group is also doing its utmost to ensure that the Group's IT systems are highly productive and efficient, in order to keep systems-related costs under control. The Group tries to develop systems that can be adopted uniformly at all Group companies (or at least portions of the system can be shared by all Group offices). In this way, we are making every effort to build an overall Group IT infrastructure with as little duplication and waste as possible. Even in the case of systems that are already developed and in use, the Group is constantly examining their systems structure and operations structure in order to keep maintenance and operations costs at a minimum.

### Structures and Measures for Maintaining Information Security

The Daiwa Securities Group's Information Security Policy, which defines the Group's response to and basic stance on information security, states that all information resources within the Group,

including personal information received from customers, must be handled in a safe, appropriate and proper manner. To ensure that this policy is followed to the fullest extent, the Group has implemented a wide range of information security measures. Organizational measures include the creation of a department with specific jurisdiction over information security matters, the appointment of information security officers in each part of the Group to promote information security policies, and the establishment of communications and reporting channels for use in an emergency. Physical and technical measures include the implementation of a "Thin Client" computer system and measures to restrict the range of users who can access certain types of information. Naturally, the computer system also includes thorough anti-virus countermeasures. Daiwa Securities' online trading systems employ highly advanced encryption technology, both in data transmission and to verify a user's identity, thus allowing clients to use the system safely and securely.

In addition, to ensure that executives and employees recognize the importance of information security, and fully understand the rules and issues involved, the Group conducts periodic in-house training sessions as part of its personnel-oriented measures to promote security.

### Efforts to Enhance the Level of Information Security

The Daiwa Securities Group is promoting the use of an Information Security Management System (ISMS) throughout the Group, in an effort to enhance the level of information security. In addition, some Group companies have already earned ISMS certification as well as the "Privacy Mark" evaluation and certification system, which indicates that they have implemented highly effective systems of information security.

## CSR Initiatives

We believe that the Daiwa Securities Group has a corporate social responsibility (CSR) to contribute to society through our core business. It is important that each and every employee is always aware of societal issues in his or her everyday work. We actively promote CSR awareness among all employees and publicize our CSR activities in the community to increase awareness of these efforts among our stakeholders.

### CSR Promotion System

The Daiwa Securities Group has adopted five principles in our efforts to promote a sustainable society.

#### (1) Engage in business activities needed by society

The securities business is highly public in nature. Our activities serve as a conduit between corporations with financing needs and investors with the need to manage their money, and facilitate the shift “from savings to investment.” In our efforts to contribute to the development of healthy financial markets, we conduct daily operations in compliance with the law and in line with social conventions.

#### (2) Operate a socially and environmentally friendly business

We encourage operations that put CSR principles into practice, and incorporate social considerations into the financial business. For example, we provide investment vehicles such as SRI (socially responsible investment) funds and bonds with coupons linked to the price of greenhouse gas emission reduction credits. These allow ordinary investors to participate in and contribute to solving environmental and social problems through their investment.

#### (3) Promote CSR outside the Group

We actively advocate CSR principles, and strive to promote CSR among stakeholders including other members of the financial industry, based on the principles of the United Nations Environment Programme Finance Initiative (UNEP FI)<sup>\*1</sup> and the Principles for Responsible Investment (PRI)<sup>\*2</sup>.

#### (4) Act as a good corporate citizen

We have included measures to promote economic and financial education in the objectives in our medium-term management plan, and are using our economic and financial expertise to cultivate a new generation of financial professionals. We will continue to provide long-term support for regional and international communities by aiding the activities of foundations and NPOs, utilizing the framework of our core financial business.

#### (5) Uphold CSR management responsibilities

We constantly consider the social and environmental impact of our business activities. Along with our efforts to strengthen corporate governance, ensure thorough compliance, increase customer satisfaction and improve the working environment, we have developed an environmental management system and are working to raise employees' awareness of environmental issues, focusing in particular on reducing the use of paper, which represents the largest direct environmental impact of our activities.

\*1 United Nations Environment Programme Finance Initiative

This initiative has been in operation since 1992 with the aim of identifying, promoting and realizing the adoption of best environmental and sustainability practices based on partnerships between the United Nations Environment Programme and financial institutions in various countries.

\*2 Principles for Responsible Investment

Investment principles published in April 2006 by the UNEP FI and the United Nations Global Compact, which aim to incorporate environmental, social and governance considerations into the investment decision-making process.

### External Communications:

The Daiwa Securities Group actively communicates with outside stakeholders, for example, by publishing an annual Sustainability Report as a CSR communication tool, responding to CSR surveys conducted by NPOs, NGOs, and other external organizations, and participating in international forums and advocacy.

In January 2007, Akira Kiyota, Deputy Chairman of the Board of Daiwa Securities Group Inc., participated as a panelist in the World Economic Forum Annual Meeting (Davos meeting) held in Switzerland. As well as presenting the initiatives of the Group, he exchanged opinions with top management of many other corporations. The Daiwa Securities Group was selected as one of the “Global 100 Most Sustainable Corporations in the World” announced at the meeting.

**SRI Funds Sold by Daiwa Securities**

(March 31, 2007)

| Fund                                | Net assets (¥ billion) |
|-------------------------------------|------------------------|
| Daiwa Eco Fund                      | 58.3                   |
| Daiwa SRI Fund                      | 9.6                    |
| Global Eco Growth Fund (Mrs. Green) | 3.7                    |
| UBS Global Equity 40                | 3.7                    |
| Total                               | 75.3                   |

In addition, Yoshinari Hara, Chairman of the Board of Daiwa Securities Group Inc., served as chairman of the Committee for the Promotion of CSR Management of the Keizai Doyukai (Japan Association of Corporate Executives) from FY 2004 to FY 2006. During this time, he worked on the issue of spreading CSR principles in Japan. The Keizai Doyukai issued a report in May 2007 that covers the Committee's activities over these three years, entitled "CSR Innovation—Creating New Corporate Value Through CSR as Part of Business Activities." The report describes the CSR activities of 92 Japanese companies, focusing on whether their products and services are environmentally friendly and whether stakeholders are given sufficient consideration in the provision of products and services, in the four categories of customers, employees, communities and the environment.

**CSR Initiatives through Core Business Activities****1. Socially Responsible Investment (SRI)**

Socially responsible investment (SRI) is a means of generating fund flows that benefit society using market mechanisms. The market for SRI is expanding year by year.

The Daiwa Securities Group markets and manages SRI funds such as the Daiwa SRI Fund and Daiwa Eco Fund. The Daiwa Eco Fund, which was launched in March 2006, invests in companies based on an evaluation of their environmental initiatives, such as the development of environmentally friendly technology or improvements in energy efficiency, and the ways in which they utilize capital. As of March 31, 2007, net assets of the Daiwa Eco Fund stood at ¥58.3 billion, making it one of the largest SRI funds in Japan.

**2. Education and Research Activities in Economic and Financial Areas**

Another area in which the Daiwa Securities Group's expertise and experience can contribute to society is through education and research in economics and finance. The Group takes part in industrial-academic collaborations, offering college courses and lectures at universities across Japan, and supports ventures that originate from universities. Group employees with experience in IPO

advisory and venture investment serve as part-time lecturers in a basic course to train venture entrepreneurs, teaching them the basic skills needed to start a business. We utilize our expertise and offer practical advice on the students' business plans from a professional standpoint. This unique form of economic education has been well received. Until FY 2006, the course was available only at Waseda University, but since FY 2007 it has been expanded to Meiji University, Chuo University and Nihon University.

We also support basic economic education for students at elementary, junior high, and senior high schools. As part of this program, we have been working with the Tokyo office of Junior Achievement, the largest NPO engaged in youth financial education in the United States, to support programs including the Student Company Program and Finance Park, which are hands-on economic and life planning education programs for junior and senior high school students. By raising the level of economic and financial literacy through these activities, we are contributing to sustainable economic growth and a stronger economic foundation in Japan.

**Supporting International Initiatives**

The Daiwa Securities Group actively supports international initiatives aimed at creating a sustainable society. In March 2004, Daiwa Securities Group Inc. signed up to the Carbon Disclosure Project<sup>\*1</sup>, and joined the aforementioned UNEP FI in November 2004. In May 2007 we signed the "Declaration on Climate Change by the Financial Services Sector"<sup>\*\*2</sup> issued by UNEP FI. Daiwa Asset Management has also signed the Principles for Responsible Investment, and adheres to the principles in its activities.

\*1 Carbon Disclosure Project

An alliance of institutional investors concerned about climate change, this project asks global companies to disclose information regarding their stance on environmental issues and measures to protect the environment.

\*\*2 Declaration on Climate Change by the Financial Services Sector

This declaration on the initiatives taken regarding climate change by world leaders in the finance industry was issued by UNEP FI to coincide with the June 2007 summit meeting in Heiligendamm, Germany.

### Corporate Citizenship Activities

The Daiwa Securities Group supports activities to benefit the community and to protect the environment, as well as volunteer activities, primarily through the CSR Promotion Department at Daiwa Securities Group Inc. The Group aims to raise awareness among its executives and employees regarding the importance of good corporate citizenship.

### Support Activities through Group Foundations

We also engage in activities that support regional and international communities through Group foundations and other channels. Daiwa Securities Health Foundation supports research aimed at preventing and treating lifestyle diseases, and works to increase awareness of health maintenance and improvement. Daiwa Securities Foundation supports a wide variety of volunteer activities associated with social welfare and medical treatment. The Daiwa Anglo-Japanese Foundation promotes mutual understanding and friendship between Japan and the United Kingdom, and each year invites “Daiwa Scholars” from the U.K. to visit Japan. In May 2007 the foundation held a reception at the Japanese embassy in the U.K. to commemorate the number of Daiwa scholars having exceeded 100.

### Environmental Initiatives

The Group’s employees are working to reduce their environmental impact with efforts to reduce energy consumption on a daily basis, by switching off office lights and electrical appliances when they are not in use and by installing energy-saving models when replacing equipment. During FY 2006, Daiwa Securities succeeded in significantly reducing the amount of paper it used by computerizing statements sent to customers and ledgers for internal use.

### Inclusion in SRI Indices

Starting in September 2006, Daiwa Securities Group Inc. has been selected as a component of the FTSE4Good Index, an index of socially responsible companies compiled by FTSE. FTSE is a subsidiary of the Financial Times (U.K.) and the London Stock Exchange. It provides data and constructs global indices for investment.

Daiwa Securities Group Inc. has also been selected for the Dow Jones Sustainability World Index (DJSI World) for the eighth consecutive year. DJSI World is an SRI stock index devised by Dow Jones Indexes (U.S.) and SAM Group (Switzerland), which assesses corporate sustainability.



### CSR Promotion under the Medium-term Management Plan

By actively increasing communication with its stakeholders, the Daiwa Securities Group is working hard to increase recognition of its CSR activities and contribute to sound economic growth.

Specifically, we are stepping up efforts in three areas.

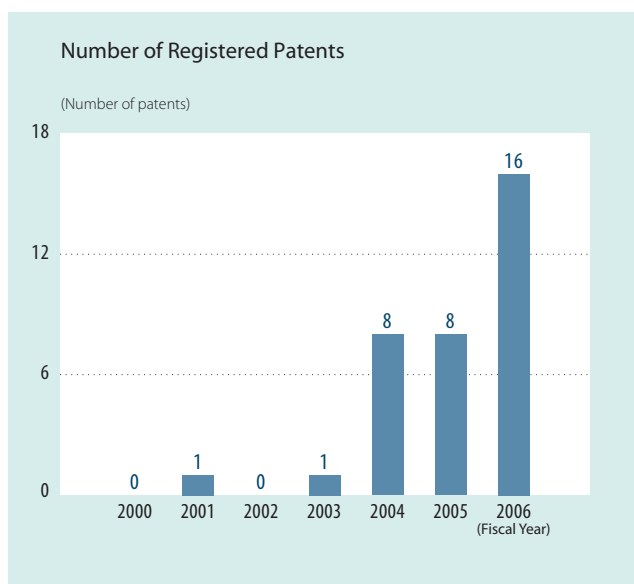
- (1) Economic and financial education: supporting education and research and promoting economic literacy through partnerships with educational institutions and NPOs;
- (2) SRI: promoting socially responsible investments
- (3) Environment: creating an environmental management system that includes formulating environmental measures in three stages, beginning with the Group’s main domestic companies, followed by the domestic consolidated subsidiaries and then its overseas subsidiaries.

Under our medium-term management plan, we are collaborating with individuals and organizations both within and outside the Group, to reinforce CSR activities.

## Intellectual Property Activities

The Daiwa Securities Group actively pursues patents, in an effort to maintain flexibility and establish a competitive advantage in future business operations. The Group encourages efforts to plan and develop new services and products that apply information technology, and will take steps to protect and utilize the Group's intellectual property.

Specifically, we aim to obtain and make use of patents in such diverse areas as SMA, securities brokerage systems, electronic document issuance, and settlement systems. The Intellectual Property Section of the Legal Department of Daiwa Securities Group Inc. cooperates with other Group companies in pursuit of this aim. Furthermore, the Group is reinforcing trademark and copyright management. Not only do we prevent infringement by other companies on the Group's intellectual property rights, but also avoid infringement by Group companies on intellectual property rights held by other companies, in accordance with corporate compliance.



### Intellectual Property Activities and Achievements

As of the end of March 2007, the Daiwa Securities Group had registered 33 patents (34 including overseas patents), and had 312 patent applications pending as of the end of March 2007.

Of the 16 patents registered in FY 2006, eight were business model patents (e-commerce), and eight were non-business model patents.

### Main Intellectual Property Measures

The Daiwa Securities Group is implementing the following measures to increase awareness of intellectual property rights, including patents, among executives and employees.

- Enhance incentive payment system for patent applications
- Operate an awards system to recognize executives and employees who contribute significantly to intellectual property activities
- Promote activities to identify patents, such as education/training and seminars on patents, in collaboration with core and strategic business divisions
- Provide information on patents via the Group's intranet, including information on patent applications and registrations from the Group and other companies as well as manuals



## Disclosure Strategy

The Daiwa Securities Group communicates proactively with shareholders, investors and the local community, in order to ensure that all stakeholders gain a proper understanding and evaluation of the Group's business activities. We aim to establish a system of disclosure that meets the very highest standards for corporate communications, providing information in a fair, prompt and appropriate manner.

### Disclosure System

The Daiwa Securities Group strives to provide information in a fair, prompt and appropriate manner, in accordance with its Disclosure Policy and Disclosure Regulations. The Group has established a Disclosure Committee—a subcommittee of the Executive Committee—as stipulated in the Disclosure Regulations. This committee is responsible for making final decisions regarding the disclosure of information. Each Group company has established its own regulations for “management-related information,” which govern the appropriate collection of information and presentation of reports to Daiwa Securities Group Inc.

The responsibilities for disclosure are clearly allocated, based on the intended recipient of the information. The Investor Relations Department handles disclosure to shareholders, investors, and analysts. The Corporate Communications Department is responsible for communications with the mass media, and the CSR Promotion Department provides information to local communities. Information is released through a variety of media, including via the Internet and in print.

### Enhancing Investor Relations Activities

The Daiwa Securities Group supplies shareholders and investors with data and explanations of its earnings results, business strategies and progress towards strategic goals, in a forthcoming manner. These disclosure activities also solicit feedback, providing management with information on market reactions and opinions to help them improve management transparency and efficiency, and thereby boost corporate value in the eyes of investors.

The Group strives to disclose information in a fair, prompt and appropriate manner, and takes steps to eliminate any disparity between the information available to domestic stakeholders and that provided to overseas stakeholders. Information on quarterly financial results is posted on the Investor Relations (IR) page of the Group's website immediately after the official announcement. The IR Department conducts a conference call with domestic analysts and institutional investors on the evening of the same day, which is also carried on the IR website, in real time. A conference call with

overseas investors is conducted later that same evening. During FY 2006, we also expanded our conferencing capabilities to respond to a rapidly increasing number of requests from analysts and institutional investors for individual IR meetings.

The Group's CEO holds briefings for investors and analysts in Japan, twice a year. In addition, the top management team travels overseas to meet with institutional investors on a regular basis. In FY 2006, conferences with investors were held in Australia and the Middle East as well as Europe, the US, Hong Kong and Singapore.

The Group is also taking steps to improve communications with individual shareholders and investors. For example, we hold regular briefings by the CEO for individual investors, and have launched a dedicated section for individual investors within our IR website, in July 2006. In addition, the Group has made use of responses to investor surveys to improve the complimentary items distributed to shareholders.

In order to encourage more shareholders to attend the General Shareholders' Meeting, which gives Group representatives an opportunity to interact directly with shareholders, since 2006 we have been holding the Meeting on a Saturday, in a spacious conference room at a hotel. For those shareholders who are unable to attend the meeting in Tokyo, the Group has traditionally broadcast this event via live satellite transmission, to venues in Osaka and Nagoya. In June 2007, we added telecast sites in Sapporo and Fukuoka. To encourage investors to exercise their voting rights, the Group allows shareholders to vote via the Internet or by mobile phone. In FY 2006, we joined the “Electronic Voting Platform for Institutional and Foreign Investors,” which allows institutional investors both in Japan and overseas to vote quickly and directly on proposals to the General Shareholders' Meeting, via the Internet.

We will continue to conduct IR activities tailored to the needs of different types of investors, in a concerted effort to promote sincere communication with our various stakeholders. Through these efforts we aim to build “Japan's best IR framework,” to serve as an example for other listed companies and to promote a vibrant securities market.