

SHINHAN FINANCIAL GROUP CO LTD  
Form 20-F  
April 30, 2015  
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As filed with the Securities and Exchange Commission on April 30, 2015

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 20-F

(Mark One)

REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR 12(g) OF THE SECURITIES EXCHANGE ACT OF 1934

OR

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2014

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

OR

**SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**Date of event requiring this shell company report**

**Commission File Number: 001-31798**

**Shinhan Financial Group Co., Ltd.**

**(Exact name of registrant as specified in its charter)**

**N/A**  
**(Translation of registrant's**

**name into English)**

**The Republic of Korea**  
**(Jurisdiction of**

**incorporation or organization)**

**20, Sejong-daero 9-gil, Jung-gu**

**Seoul 100-724, Korea**

**(Address of principal executive offices)**

**Yu Sunghun, +822 6360 3071(T), irshy@shinhan.com, +822 6360 3098 (F), 20, Sejong-daero 9-gil, Jung-gu, Seoul 100-724, Korea**

**(Name, Telephone, E-mail and/or Facsimile number and Address of Company Contact Person)**

**Securities registered or to be registered pursuant to Section 12(b) of the Act:**

<b>Title of Each Class:</b>	<b>Name of Each Exchange on Which Registered:</b>
Common stock, par value Won 5,000 per share	New York Stock Exchange*
American depositary shares	New York Stock Exchange

\* Not for trading, but only in connection with the listing of American depositary shares on the New York Stock Exchange, pursuant to the requirements of the Securities and Exchange Commission.

**Securities registered or to be registered pursuant to Section 12(g) of the Act:**

None

**Securities for which there is a reporting obligation pursuant to Section 15(d) of the Act:**

None

Indicate the number of outstanding shares of each of Shinhan Financial Group's classes of capital or common stock as of the close of the last full fiscal year covered by this Annual Report: 474,199,587 shares of common stock, par value of Won 5,000 per share.

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act: Yes  No

If this report is an annual or transition report, indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934: Yes  No

Note Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 from their obligations under those Sections.

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark which basis of accounting the registrant has used to prepare the financial statements included in this filing:

U.S. GAAP  International Financial Reporting Standards as issued  Other

by the International Accounting Standards Board

If **Other** has been checked in response to the previous question, indicate by check mark which financial statement item the registrant has elected to follow: Item 17  Item 18

If this is an annual report, indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act): Yes  No

**(APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PAST FIVE YEARS)**

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court: Yes  No

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**CERTAIN DEFINED TERMS, CONVENTIONS AND CURRENCY OF PRESENTATION**

Unless otherwise specified or the context otherwise requires:

the terms we, us, our, Shinhan Financial Group, SFG and the Group mean Shinhan Financial Group and its consolidated subsidiaries; and

the terms Shinhan Financial Group Co., Ltd., our company and our holding company mean Shinhan Financial Group Co., Ltd.

All references to Korea or the Republic contained in this annual report mean The Republic of Korea. All references to the Government mean the government of The Republic of Korea. The Financial Supervisory Service is the executive body of the Financial Services Commission of Korea ( Financial Services Commission ). References to MOSF are to the Ministry of Strategy and Finance of Korea.

The fiscal year for us and our subsidiaries ends on December 31 of each year, except Shinhan Savings Bank whose fiscal year ends on June 30 of each year. Unless otherwise specified or the context otherwise requires, all references to a particular year are to the year ended December 31 of that year.

The currency of the primary economic environment in which we operate is Korean Won.

In this annual report, unless otherwise indicated, all references to Won ~~₩~~ W are to the currency of The Republic of Korea, and all references to U.S. Dollars, Dollars, \$ or US\$ are to the currency of the United States of America. Unless otherwise indicated, all translations from Won to Dollars were made at ₩1,090.9 to US\$1.00, which was the noon buying rate in the City of New York on December 31, 2014 for cable transfers according to the H.10 statistical release of the Federal Reserve Board (the Noon Buying Rate ). On April 10, 2015, the Noon Buying Rate was ₩1,093.1 to US\$1.00. The Noon Buying Rate has been volatile recently and the U.S. Dollar amounts referred to in this report should not be relied upon as an accurate reflection of our results of operations. We expect this volatility to continue in the near future. No representation is made that the Won or U.S. Dollar amounts referred to in this report could have been or could be converted into Dollars or Won, as the case may be, at any particular rate or at all.

Unless otherwise indicated, the financial information presented in this annual report has been prepared on a consolidated basis in accordance with International Financial Reporting Standards ( IFRS ) as issued by the International Accounting Standards Board ( IASB ).

Any discrepancies in the tables included herein between totals and sums of the amounts listed are due to rounding.

**FORWARD LOOKING STATEMENTS**

This annual report includes forward-looking statements, as defined in Section 27A of the U.S. Securities Act, as amended, and Section 21E of the U.S. Securities Exchange Act of 1934, as amended (the Exchange Act ), including statements regarding our expectations and projections for future operating performance and business prospects. The words believe, expect, anticipate, estimate, project and similar words used in connection with any discussion of future operating or financial performance identify forward-looking statements. In addition, all statements other than statements of historical facts included in this annual report are forward-looking statements.



Although we believe that the expectations reflected in the forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. All forward-looking statements are management's present expectations of future events and are subject to a number of factors and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. This

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annual report discloses, under the caption "Item 3.D. Risk Factors" and elsewhere, important factors that could cause actual results to differ materially from our expectations ("Cautionary Statements"). Included among the factors discussed under the caption "Item 3.D. Risk Factors" are the following risks related to our business, which could cause actual results to differ materially from those described in the forward-looking statements: the risk of adverse impacts from an economic downturn; increased competition; market volatility in securities and derivatives markets, interest or foreign exchange rates or indices; other factors impacting our operational plans; or legislative and/or regulatory developments. We caution you not to place undue reliance on the forward-looking statements, which speak only as of the date of this annual report. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the Cautionary Statements.

**Table of Contents****ITEM 1. IDENTITY OF DIRECTORS, SENIOR MANAGEMENT AND ADVISERS**

Not applicable.

**ITEM 2. OFFER STATISTICS AND EXPECTED TIMETABLE**

Not applicable.

**ITEM 3. KEY INFORMATION****ITEM 3.A. Selected Financial Data**

The selected consolidated income statement and balance sheet data set forth below for the years ended December 31, 2010, 2011, 2012, 2013 and 2014 have been derived from our consolidated financial statements which have been prepared in accordance with IFRS as issued by the IASB. Our consolidated financial statements as of and for the years ended December 31, 2010, 2011, 2012, 2013 and 2014 have been audited by independent registered public accounting firm KPMG Samjong Accounting Corp.

You should read the following data with the more detailed information contained in Item 5. Operating and Financial Review and Prospects and our consolidated financial statements included in Item 18. Financial Statements. Historical results are not necessarily indicative of future results.

**Consolidated Income Statement Data**

	<b>Year Ended December 31,</b>					
	<b>2010</b>	<b>2011</b>	<b>2012<sup>(1)</sup></b>	<b>2013<sup>(1)</sup></b>	<b>2014</b>	<b>2014<sup>(2)</sup></b>
	<b>(In billions of Won and millions of US\$, except per common share data)</b>					
Interest income	₩ 12,909	₩ 13,781	₩ 13,999	₩ 12,591	₩ 12,061	\$ 11,056
Interest expense	(6,436)	(6,701)	(7,019)	(5,986)	(5,271)	(4,832)
<b>Net interest income</b>	<b>6,473</b>	<b>7,080</b>	<b>6,980</b>	<b>6,605</b>	<b>6,790</b>	<b>6,224</b>
Fees and commission income	3,397	3,557	3,491	3,490	3,561	3,264
Fees and commission expense	(1,640)	(1,798)	(1,948)	(2,103)	(2,092)	(1,917)
<b>Net fees and commission income</b>	<b>1,757</b>	<b>1,759</b>	<b>1,543</b>	<b>1,387</b>	<b>1,469</b>	<b>1,347</b>
Net insurance loss	(76)	(119)	(211)	(383)	(413)	(379)
Dividend income	217	209	174	156	176	161
Net trading income (loss)	334	(132)	608	75	262	241
Net foreign currency transaction gain	117	14	280	296	224	205
Net gain (loss) on financial instruments designated at fair value through profit or loss	(125)	172	(532)	(122)	(361)	(331)
	652	846	536	701	681	624

Net gain on sale of available-for-sale  
financial assets

Impairment losses on financial assets	(1,336)	(983)	(1,416)	(1,340)	(1,174)	(1,077)
General and administrative expenses	(3,789)	(3,983)	(4,062)	(4,203)	(4,463)	(4,091)
Net other operating expenses	(613)	(538)	(724)	(540)	(536)	(491)
<b>Operating income</b>	<b>3,611</b>	<b>4,325</b>	<b>3,176</b>	<b>2,632</b>	<b>2,655</b>	<b>2,433</b>
Equity method income	15	58	28	7	31	28
Other non-operating income (loss), net	(138)	(38)	25	37	182	167
<b>Profit before income taxes</b>	<b>3,488</b>	<b>4,345</b>	<b>3,229</b>	<b>2,676</b>	<b>2,868</b>	<b>2,628</b>

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	Year Ended December 31,					
	2010	2011	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	2014	2014 <sup>(2)</sup>
	(In billions of Won and millions of US\$, except per common share data)					
Income tax expense	(584)	(957)	(739)	(621)	(668)	(612)
<b>Profit for the year</b>	<b>₩ 2,904</b>	<b>₩ 3,388</b>	<b>₩ 2,490</b>	<b>₩ 2,055</b>	<b>₩ 2,200</b>	<b>\$ 2,016</b>
<b>Other comprehensive income (loss) for the year, net of income tax</b>						
Items that are or may be reclassified to profit or loss:						
Foreign currency translation adjustments for foreign operations	₩ (18)	₩ 16	₩ (85)	₩ (58)	₩ (13)	\$ (12)
Net change in unrealized fair value of available-for-sale financial assets	175	(461)	13	(269)	136	125
Equity in other comprehensive income of associates	21	3	4	(5)	6	6
Net change in unrealized fair value of cash flow hedges	13	1	16	6	(16)	(15)
Other comprehensive income (loss) of separate account	2		1	(2)	6	5
	193	(441)	(51)	(328)	119	109
Items that will never be reclassified to profit or loss:						
Remeasurements of defined benefit liability	(45)	(115)		19	(155)	(141)
	(45)	(115)		19	(155)	(141)
Total other comprehensive loss, net of income tax	148	(556)	(51)	(309)	(36)	(32)
<b>Total comprehensive income for the year</b>	<b>₩ 3,052</b>	<b>₩ 2,832</b>	<b>₩ 2,439</b>	<b>₩ 1,746</b>	<b>₩ 2,164</b>	<b>\$ 1,984</b>
Net income attributable to:						
Equity holders of the Group	₩ 2,729	₩ 3,215	₩ 2,320	₩ 1,898	₩ 2,081	\$ 1,908
Non-controlling interest	175	173	170	157	119	108
Total comprehensive income attributable to:						
Equity holders of the Group	2,876	2,660	2,267	1,591	2,046	1,876
Non-controlling interest	176	172	172	155	118	108
Earnings per share:						
Basic earnings per share in Won and US\$ <sup>(3)</sup>	5,269	6,195	4,681	3,810	4,195	3.85
	5,167	6,065	4,681	3,810	4,195	3.85

Dilutive earnings per share in Won and  
US\$(4)

*Notes:*

- (1) We have restated our consolidated statements of comprehensive income for the years ended December 31, 2012 and 2013 and our consolidated statements of financial position as of December 31, 2012 and December 31, 2013 to give effect to changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.
- (2) Won amounts are expressed in U.S. dollar at the rate of ₩1,090.9 to US\$1.00, the Noon Buying Rate in effect on December 31, 2014 for the convenience of readers. No representation is made that the Won or U.S. dollar amounts referred to above could have been or could be converted into U.S. dollars or Won, as the case may be, at any particular rate or at all.

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- (3) Basic earnings per share are calculated by dividing net income available to holders of our common shares by the weighted average number of common shares issued and outstanding for the relevant period.
- (4) Dilutive earnings per share are calculated in a manner consistent with basic earnings per share, while giving effect to the potential dilution that could occur if convertible securities, options or other contracts to issue common shares were converted into or exercised for common shares. Common shares issuable upon conversion of redeemable convertible preferred shares are potentially dilutive.

**Consolidated Balance Sheet Data**

	As of December 31,					
	2010	2011	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	2014	2014 <sup>(2)</sup>
	(In billions of Won and millions of US\$, except per common share data)					
<b>Assets</b>						
Cash and due from banks	₩ 11,822	₩ 14,731	₩ 13,507	₩ 16,473	₩ 20,585	\$ 18,870
Trading assets	9,412	11,954	16,654	18,033	24,362	22,332
Financial assets designated at fair value through profit or loss	2,208	1,801	2,542	3,361	2,737	2,509
Derivative assets	3,159	2,319	2,171	1,717	1,568	1,438
Loans, net	181,347	192,573	200,289	205,723	221,618	203,151
Available-for-sale financial assets	29,452	34,106	36,284	33,597	31,418	28,800
Held-to-maturity financial assets	12,529	11,895	11,660	11,031	13,373	12,259
Property and equipment, net	2,976	2,994	3,108	3,214	3,147	2,885
Intangible assets, net	4,073	4,203	4,195	4,226	4,153	3,807
Investments in associates	300	249	299	329	342	313
Current tax receivable	11	9	14	6	11	10
Deferred tax assets	65	29	100	196	228	209
Investment properties, net	286	275	779	690	268	245
Other assets, net	9,949	10,888	13,283	12,451	14,203	13,019
Assets held for sale	21	16	54	243	9	8
<b>Total assets</b>	<b>₩ 267,610</b>	<b>₩ 288,042</b>	<b>₩ 304,939</b>	<b>₩ 311,290</b>	<b>₩ 338,022</b>	<b>\$ 309,855</b>
<b>Liabilities</b>						
Deposits	₩ 149,417	₩ 163,016	₩ 173,296	₩ 178,810	₩ 193,710	\$ 177,569
Trading liabilities	823	704	1,371	1,258	2,689	2,465
Financial liabilities designated at fair value through profit or loss	1,954	3,298	4,822	5,909	8,996	8,247
Derivative liabilities	2,588	1,972	1,904	2,019	1,718	1,574
Borrowings	18,085	20,033	19,537	20,143	22,974	21,059
Debt securities issued	40,286	39,737	38,838	37,491	37,335	34,224
Liability for defined benefit obligations	170	275	222	118	309	284

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Provisions	859	870	748	750	694	636
Current tax payable	251	568	254	239	257	236
Deferred tax liabilities	184		42	15	10	9
Liabilities under insurance contracts	8,986	10,867	13,420	15,662	17,776	16,295
Other liabilities	16,812	19,843	21,574	19,021	21,040	19,287
<b>Total liabilities</b>	<b>₩ 240,415</b>	<b>₩ 261,183</b>	<b>₩ 276,028</b>	<b>₩ 281,435</b>	<b>₩ 307,508</b>	<b>\$ 281,885</b>



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	As of December 31,					
	2010	2011	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	2014	2014 <sup>(2)</sup>
	(In billions of Won and millions of US\$, except per common share data)					
<b>Equity</b>						
Capital stock	₩ 2,590	₩ 2,645	₩ 2,645	₩ 2,645	₩ 2,645	\$ 2,425
Hybrid bond		239	537	537	537	493
Capital surplus	8,835	9,887	9,887	9,887	9,887	9,063
Capital adjustments	(391)	(393)	(393)	(393)	(393)	(361)
Accumulated other comprehensive income	1,584	1,030	980	673	638	585
Retained earnings	12,116	10,989	12,714	14,189	15,869	14,545
Total equity attributable to equity holders of the Group	24,734	24,397	26,370	27,538	29,183	26,750
Non-controlling interest	2,461	2,462	2,541	2,317	1,331	1,220
<b>Total equity</b>	<b>₩ 27,195</b>	<b>₩ 26,859</b>	<b>₩ 28,911</b>	<b>₩ 29,855</b>	<b>₩ 30,514</b>	<b>\$ 27,970</b>
<b>Total liabilities and equity</b>	<b>₩ 267,610</b>	<b>₩ 288,042</b>	<b>₩ 304,939</b>	<b>₩ 311,290</b>	<b>₩ 338,022</b>	<b>\$ 309,855</b>

*Notes:*

- (1) We have restated our consolidated statements of comprehensive income for the years ended December 31, 2012 and 2013 and our consolidated statements of financial position as of December 31, 2012 and December 31, 2013 to give effect to changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.
- (2) Won amounts are expressed in U.S. dollar at the rate of ₩1,090.9 to US\$1.00, the Noon Buying Rate in effect on December 31, 2014 for the convenience of readers. No representation is made that the Won or U.S. dollar amounts referred to above could have been or could be converted into U.S. dollars or Won, as the case may be, at any particular rate or at all.

**Dividends**

	Year Ended December 31,				
	2010	2011	2012	2013	2014
	(In Won and US\$)				
<b>Cash dividends per share of common stock:</b>					
In Korean Won	₩ 750	₩ 750	₩ 700	₩ 650	₩ 950
In U.S. Dollars <sup>(1)</sup>	\$ 0.66	\$ 0.65	\$ 0.66	\$ 0.62	\$ 0.87
<b>Cash dividends per share of preferred stock:</b>					
In Korean Won	₩ 5,275	₩ 4,996	₩ 5,580	₩ 5,580	₩ 5,580
In U.S. Dollars <sup>(1)</sup>	\$ 4.62	\$ 4.31	\$ 5.25	\$ 5.29	\$ 5.12

*Note:*

- (1) Won amounts for 2010, 2011, 2012, 2013 and 2014 are expressed in U.S. dollar at the rate of ₩1,130.6, ₩1,158.5, ₩1,063.2, ₩1,055.3 and ₩1,090.9, respectively, to US\$1.00, the Noon Buying Rate in effect on December 31, 2010, 2011, 2012, 2013 and 2014, respectively, for the convenience of readers. No representation is made that the Won or U.S. dollar amounts referred to above could have been or could be converted into U.S. dollars or Won, as the case may be, at any particular rate or at all.

**Table of Contents****Selected Statistical Information****Profitability Ratios**

	2010	Year Ended December 31,			2014
		2011	2012 <sup>(1)</sup>	2013 <sup>(1)</sup>	
(Percentages)					
Net income attributable to the Group as a percentage of:					
Average total assets <sup>(2)</sup>	0.98%	1.09%	0.82%	0.66%	0.68%
Average total Group stockholders' equity <sup>(3)</sup>	10.36	10.89	8.83	7.03	7.25
Dividend payout ratio <sup>(3)</sup>	21.84	20.39	16.77	19.47	24.66
Net interest spread <sup>(2)(4)</sup>	2.29	2.34	2.11	1.95	1.93
Net interest margin <sup>(2)(5)</sup>	2.69	2.80	2.57	2.36	2.31
Efficiency ratio <sup>(6)</sup>	87.39	82.53	85.98	88.25	87.31
Cost-to-income ratio <sup>(7)</sup>	44.03	44.79	47.45	52.41	55.32
Cost-to-average assets ratio <sup>(2)(8)</sup>	8.85	7.23	6.54	6.48	6.09
Equity to average asset ratio <sup>(2)(9)</sup>	9.49	9.97	9.31	9.43	9.36

*Notes:*

- (1) The amounts for 2012 and 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.
- (2) Average total assets, liabilities and stockholders' equity are based on (a) daily balances for Shinhan Bank and (b) quarterly balances for other subsidiaries.
- (3) Represents the ratio of total dividends declared on common and preferred stock as a percentage of net income attributable to the Group.
- (4) Represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
- (5) Represents the ratio of net interest income to average interest-earning assets.
- (6) Represents the ratio of non-interest expense to the sum of net interest income and non-interest income. Efficiency ratio is used as a measure of efficiency for banks and financial institutions. Efficiency ratio may be reconciled to comparable line-items in our income statements for the periods indicated as follows:

	2010	Year Ended December 31,			2014
		2011	2012	2013	
(In billions of Won, except percentages)					
Non-interest expense (A)	₩ 24,124	₩ 20,505	₩ 19,802	₩ 20,100	₩ 19,733
<i>Divided by</i>					
The sum of net interest income and non-interest	27,606	24,845	23,031	22,776	22,601

income (B)					
Net interest income	6,473	7,080	6,980	6,605	6,790
Non-interest income	21,133	17,765	16,051	16,171	15,811
Efficiency ratio ((A) as a percentage of (B))	87.39%	82.53%	85.98%	88.25%	87.31%

- (7) Represents the ratio of general and administrative expenses to the sum of net interest income, net fee and commission income, net gain on financial assets and liabilities at fair value through profit or loss and net other operating income.
- (8) Represents the ratio of non-interest expense to average total assets.
- (9) Represents the ratio of average stockholders' equity to average total assets.

**Table of Contents****Asset Quality Ratios**

	As of December 31,				
	2010	2011	2012	2013	2014
	(In billions of Won, except percentages)				
Total gross loans	₩ 184,249	₩ 195,055	₩ 202,916	₩ 207,987	₩ 223,879
Total allowance for loan losses	₩ 2,852	₩ 2,577	₩ 2,800	₩ 2,476	₩ 2,501
Allowance for loan losses as a percentage of total loans	1.55%	1.32%	1.38%	1.19%	1.12%
Impaired loans <sup>(1)</sup>	₩ 2,757	₩ 2,457	₩ 2,658	₩ 2,386	₩ 2,127
Impaired loans as a percentage of total loans	1.50%	1.26%	1.31%	1.15%	0.95%
Allowance as a percentage of impaired loans	103.45%	104.88%	105.34%	103.77%	117.58%
Total non-performing loans <sup>(2)</sup>	₩ 1,427	₩ 1,416	₩ 1,695	₩ 1,197	₩ 1,286
Non-performing loans as a percentage of total loans	0.77%	0.73%	0.84%	0.58%	0.57%
Allowance as a percentage of total assets	1.06%	0.89%	0.92%	0.80%	0.74%

*Notes:*

- (1) Impaired loans include (i) loans for which the borrower has defaulted under Basel standards applicable during the relevant period and (ii) loans that qualify as troubled debt restructurings applicable during the relevant period.
- (2) Non-performing loans are defined as loans, whether corporate or retail, that are past due more than 90 days.

**Capital Ratios**

	As of December 31,				
	2010	2011	2012	2013	2014
	(Percentages)				
Group BIS ratio <sup>(1)</sup>	12.38%	11.41%	12.46%	13.43%	13.05%
Total capital adequacy ratio of Shinhan Bank	15.47	15.26	15.83	16.29	15.43
Adjusted equity capital ratio of Shinhan Card <sup>(2)</sup>	24.99	25.81	27.43	30.41	29.69
Solvency ratio for Shinhan Life Insurance <sup>(3)</sup>	397.93	324.02	287.70	253.06	230.69

*Notes:*

(1)

Under the guidelines of the Financial Services Commission applicable to financial holding companies, the minimum requisite capital ratio applicable to us is the Bank for International Settlement ( BIS ) ratio of 8%. This computation is based on our consolidated financial statements in accordance with IFRS. See Item 4.B. Business Overview Supervision and Regulation Principal Regulations Applicable to Financial Holding Companies Capital Adequacy.

- (2) Represents the ratio of total adjusted shareholders equity to total adjusted assets and is computed in accordance with the guidelines issued by the Financial Services Commission for credit card companies. Under these guidelines, a credit card company is required to maintain a minimum adjusted equity capital ratio of 8%. This computation is based on the consolidated financial statements of the credit card company prepared in accordance with IFRS. See Item 4.B. Business Overview Supervision and Regulation Principal Regulations Applicable to Credit Card Companies Capital Adequacy.
- (3) Solvency ratio is the ratio of the solvency margin to the standard amount of solvency margin as defined and computed in accordance with the guidelines issued by the Financial Services Commission for life insurance companies. Under these guidelines, Shinhan Life Insurance is required to maintain a minimum solvency ratio of 100%. See Item 4.B. Business Overview Supervision and Regulation Principal Regulations Applicable to Insurance Companies Capital Adequacy.

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The Financial Services Commission regulations require that capital ratios be computed based on our consolidated financial statements under IFRS and regulatory guidelines. The following table sets forth our capital ratios computed on the basis of our consolidated financial statements under IFRS and the regulatory guidelines of the Financial Services Commission.

	As of December 31,		
	2012	2013	2014
(In millions of Won, except percentages)			
Risk-weighted assets	₩ 201,184,402	₩ 190,716,648	₩ 198,832,860
Total risk-adjusted capital	₩ 25,075,736	₩ 25,605,827	₩ 25,937,968
Tier 1 capital	₩ 19,124,728	₩ 21,538,399	₩ 22,174,353
Capital adequacy ratio (%)	12.46%	13.43%	13.05%
Tier 1 capital ratio (%)	9.51%	11.29%	11.15%

**Exchange Rates**

The following table sets forth, for the periods and dates indicated, certain information concerning the Noon Buying Rate in Won per US\$1.00.

Year Ended December 31,	At End of Period	Average <sup>(1)</sup>	High	Low
	(Won per US\$1.00)			
2010	1,130.6	1,158.7	1,253.2	1,104.0
2011	1,158.5	1,105.2	1,197.5	1,049.2
2012	1,063.2	1,119.6	1,185.0	1,063.2
2013	1,055.3	1,094.6	1,161.3	1,050.1
2014	1,090.9	1,054.0	1,117.7	1,008.9
October	1,073.1	1,073.1	1,074.4	1,043.9
November	1,112.1	1,112.1	1,114.7	1,077.0
December	1,090.9	1,090.9	1,117.7	1,080.8
2015 (through April 10)	1,093.1	1,101.5	1,135.7	1,075.3
January	1,104.3	1,104.3	1,109.1	1,075.3
February	1,100.7	1,100.7	1,112.8	1,086.8
March	1,107.7	1,107.7	1,135.7	1,095.7
April (through April 10)	1,093.1	1,093.1	1,098.1	1,083.4

Source: Federal Reserve Board

Note:

(1) Represents the average of the Noon Buying Rates on the last day of each month during the relevant period. We have translated certain amounts in Korean Won, which appear in this annual report, into U.S. Dollars for convenience. This does not mean that the Won amounts referred to could have been, or could be, converted into U.S.

Dollars at any particular rate, the rates stated above, or at all. Unless otherwise stated, translations of Won amounts to U.S. Dollars are based on the Noon Buying Rate in effect on December 31, 2014, which was ₩1,090.9 to US\$1.00. On April 10, 2014, the Noon Buying Rate in effect was ₩1,093.1 to US\$1.00.

**ITEM 3.B. Capitalization and Indebtedness**

Not applicable.

**ITEM 3.C. Reasons for the Offer and Use of Proceeds**

Not applicable.



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**ITEM 3.D. Risk Factors**

*An investment in the American depositary shares representing our common shares involves a number of risks. You should carefully consider the following information about the risks we face, together with the other information contained in this annual report, in evaluating us and our business.*

**Risks Relating to Our Overall Business**

***Difficult conditions and turbulence in the Korean and global economy and financial markets may adversely affect our business, asset quality, capital adequacy and earnings.***

Most of our assets are located in, and we generate most of our income from, Korea. Accordingly, our business and profitability are largely dependent on the general economic and social conditions in Korea, including interest rates, inflation, exports, personal expenditures and consumption, unemployment, demand for business products and services, debt service burden of households and businesses, the general availability of credit, the asset value of real estate and securities and other factors affecting the financial well-being of our corporate and retail customers.

The Korean economy is closely integrated with, and is significantly affected by, developments in the global economy. In light of the ongoing general economic weakness and political turbulence in Europe, signs of cooling economy for China and the continuing political instability in the Middle East and the former republics of the Soviet Union, including Russia, among others, significant uncertainty remains as to the global economic prospects in general and has adversely affected, and may continue to adversely affect, the Korean economy. In addition, as the Korean economy matures, it is increasingly exposed to the risk of a "scissor effect", namely being pursued by competitors in less advanced economies while not having fully caught up with competitors in advanced economies, which risk is amplified by the fact that Korean economy is heavily dependent on exports. The Korean economy also continues to face other difficulties, including sluggishness in domestic consumption and investment, weakness in the real estate market, rising household debt, potential declines in productivity due to aging demographics and a rise in youth unemployment. Any future deterioration of the global and Korean economies could adversely affect our business, financial condition and results of operations.

In particular, difficulties in financial and economic conditions could result in significant deterioration in the quality of our assets and accumulation of higher provisioning, allowances for loan losses and charge-offs as an increasing number of our corporate and retail customers declare bankruptcy or insolvency or otherwise face increasing difficulties in meeting their debt obligations. In addition, the continuing slump in the real estate market and the shipbuilding and shipping industries has led to increased delinquency among our corporate borrowers in the construction, real estate leasing, shipbuilding and shipping industries (and in certain cases, even insolvency, corporate restructurings and/or voluntary arrangements with creditors, as was the case for the current and former member companies of the STX Group, Keangnam Enterprises and Dongbu Steel, to each of which we have limited exposure). While we have sought to actively reduce our exposure to such troubled industries through preemptive risk management policies, we cannot assure you that we will not experience further loan losses from borrowers in these industries since the quality of their assets may further deteriorate due to the continued slump in these industries or for other reasons. Shinhan Bank's delinquency ratio (based on one or more month of delinquency) increased from 0.48% in 2010 to 0.60% in 2011 and 0.61% in 2012, but decreased to 0.39% in 2013 and further to 0.31% in 2014, primarily due to Shinhan Bank's active efforts to reduce its exposure to such troubled industries and other at-risk borrowers through preemptive risk management policies and increased lending to borrowers with high-quality credit profiles as part of Shinhan Bank's strategic initiative to improve its asset quality. As for Shinhan Card, its delinquency ratio under the Financial Services Commission guidelines increased from 2.01% in 2010 to 2.27% in 2011 and 2.64% in 2012 largely as a result of an increase in its assets, before stabilizing to 2.15% and 2.18% in 2013 and 2014, respectively, largely as a result of its enhanced preemptive risk management and controlled asset growth as well as the sale of large

non-performing loans to improve its asset quality.

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Moreover, depending on the nature of the difficulties in the financial markets and general economy, we may be forced to scale back certain of our core lending activities and other operations and/or borrow money at a higher funding cost or face a tightening in the net interest spread, any of which may have a negative impact on our earnings and profitability. Furthermore, while we and our principal subsidiaries currently maintain a capital adequacy ratio at a level higher than the required regulatory minimum, there is no guarantee that an even higher capital requirement will not be imposed by the Government in case of a renewed economic crisis.

In addition, given the highly integrated nature of financial systems and economic relationships worldwide, there may be unanticipated systemic or other risks that may not be presently predictable. Any of these risks if materialized may have a material adverse effect on our business, liquidity, financial condition and results of operations.

***Competition in the Korean financial services industry is intense, and may further intensify.***

Competition in the Korean financial services industry is, and is likely to remain, intense, including as a result of the sustained low interest rate environment (which narrows opportunities to make profit based on the spread between lending rates and funding rates), the continuing sluggishness in the general economy, the growing maturation and saturation of the industry as a whole, the entry of new market participants and deregulation, among others.

In the banking sector, Shinhan Bank competes principally with other national commercial banks in Korea, but also faces competition from a number of additional banking institutions, including branches and subsidiaries of foreign banks operating in Korea, regional banks, government-owned development banks and Korea's specialized banks, such as Korea Development Bank, the Industrial Bank of Korea and the National Association of Agriculture and Fisheries, as well as various other types of financial service providers, including savings institutions (such as mutual savings and finance companies, credit unions and credit cooperatives), investment companies (such as securities brokerage firms, merchant banking corporations and asset management companies) and life insurance companies. As of December 31, 2014, Korea had seven major nationwide domestic commercial banks (including Citibank Korea Inc. and Standard Chartered Bank Korea Limited, both of which are domestic commercial banks acquired by global financial institutions), six regional commercial banks and branches and subsidiaries of 40 foreign banks. Foreign financial institutions, many of which have greater experiences and resources than we do, may continue to enter the Korean market and compete with us in providing financial products and services either by themselves or in partnership with existing Korean financial institutions.

In the small- and medium-sized enterprise and retail banking segments, which have been Shinhan Bank's traditional core businesses, competition is expected to increase further. In recent years, Korean banks, including Shinhan Bank, have increasingly focused on stable asset growth based on quality credit, such as corporate borrowers with high credit ratings, loans to small office, home office (SOHO) with high levels of collateralization, and mortgage and home equity loans within the limits of the prescribed loan-to-value ratios and debt-to-income ratios. This common shift in focus toward stable growth based on less risky assets has intensified competition as banks compete for the same limited pool of quality credit by engaging in price competition or by other means although Shinhan Bank has traditionally focused, and will continue to focus, on enhancing profitability rather than increasing asset size or market share, and has avoided, to the extent practicable, engaging in price competition by way of lowering lending rates. In addition, such competition may result in lower net interest margin and reduced overall profitability, especially if the low interest rate environment were to continue for a significant period of time. Therefore, if competing financial institutions seek to expand market share by lowering their lending rates, Shinhan Bank may suffer customer loss, especially among customers who select their lenders principally on the basis of lending rates. In response thereto or for other strategic reasons, Shinhan Bank may subsequently lower its own lending rates to stay competitive, which could lead to a decrease in its net interest margins and outweigh any positive impact on the net interest margin from a general rise in market interest rates. Any future decline in Shinhan Bank's customer base or its net interest margins

could have an adverse effect on our results of operations and financial condition.

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In the credit card sector, Shinhan Card competes principally with existing monoline credit card companies, credit card divisions of commercial banks, consumer finance companies, other financial institutions and, recently, credit card service providers allied with mobile telecommunications service providers in Korea. Competition has been historically intense in this sector and the market has shown signs of saturation as existing and new credit card service providers make significant investments and engage in aggressive marketing campaigns and promotions to acquire new customers and target customers with high credit quality. While competition has subsided somewhat recently due to stricter government regulations, such as curbs on excessive marketing expenses, competition remains intense and credit card issuers may continue to compete with Shinhan Card for customers by offering lower interest rates and fees, higher credit limits, more attractive promotions and incentives and alternative products such as phone cards, gift cards and low-interest consumer loan products. As a result, Shinhan Card may lose customers or service opportunities to competing credit card issuers and/or incur higher marketing expenses. In addition, the Government regulations adopted in 2012 mandating lower merchant fees chargeable to small- and medium-sized businesses and the Government guidelines issued in 2013 suggesting lower standard interest rates for cash advances and card loans have reduced and are likely to continue to limit the revenues of credit card companies, including Shinhan Card. Furthermore, the Government's recent guidelines to bolster consumer protection and protect customers' personal data in the aftermath of data leaks at certain credit companies (not including Shinhan Card) may result in additional compliance costs for Shinhan Card. Customer attrition, together with any further lowering of fees or reduction in base and market interest rates and/or additional expenses from more extensive marketing and promotional campaigns that Shinhan Card might implement to acquire and retain customers, could reduce its revenues and earnings. Furthermore, the average credit quality of Shinhan Card's customers may deteriorate if customers with higher credit quality borrow from our competitors rather than Shinhan Card and it may become more difficult for Shinhan Card to attract and maintain quality customers. In general, the growth, market share and profitability of Shinhan Card's operations may decline or become negative as a result of market saturation in this sector, interest rate competition, pressure to lower fee rates and incur higher marketing expenses, as well as Government regulation and social and economic developments in Korea that are beyond our control, such as changes in consumer confidence levels, spending patterns or public perception of credit card usage and consumer debt. If Shinhan Card fails to maintain or attract new cardholders or increase the card usage by existing customers or experiences deterioration in its asset quality and a rise in delinquency, our business, financial condition and results of operations may be adversely affected.

In other financial services sectors, our other subsidiaries also compete in a highly fragmented market. Some of our competitors, particularly the major global financial institutions, have greater experience and resources than we do.

Consolidation among our rival institutions may also add competition in the markets in which we and our subsidiaries conduct business. The Korean banking industry may undergo further consolidation either voluntarily or as part of government-led initiatives, including privatization, although the Government announced in March 2013 that it would no longer pursue privatization of Korea Development Bank and Industrial Bank of Korea. Some of the financial institutions resulting from these developments may, by virtue of their increased size, expanded business scope and more efficient operations, provide greater competition for us. For example, partly to facilitate the sale of Government-invested members of the former Woori Financial Group which had not materialized despite a prolonged attempt to sell them as a whole, beginning in 2013 the Government has promoted the sale of such members in three separate groups (namely, commercial banking, regional banking, and securities and investment). As a result, the securities and investment members of the former Woori Financial Group (including Woori Investment & Securities) were sold to other domestic financial institutions in the first half of 2014 and their regional banking members (namely, Kyongnam Bank and Gwangju Bank) were sold to other domestic financial institutions in October 2014. In November 2014, Woori Financial Group was dissolved and merged into Woori Bank, with all the remaining subsidiaries of the former Woori Financial Group having been converted into subsidiaries of Woori Bank. The Government continues to seek to sell Woori Bank, and the outlook for such sale remains uncertain. If one of major competitors or a foreign financial institution were to acquire Woori Bank or any of its major operating subsidiaries, the consolidated entity

may have a greater scale of

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operations, including a larger customer base, and financial resources than us, which may hurt our ability to compete effectively. In addition, in April 2013, Korea Exchange Bank became part of Hana Financial Group after acquisition of the former by the latter in February 2012, and in October 2014, Korea Exchange Bank entered into an agreement to be merged into Hana Bank, one of the major commercial banks in Korea. Any of these developments may place us at a competitive disadvantage and outweigh any potential benefit to us in the form of opportunities to acquire new customers who are displeased with the level of services at the newly reorganized entities or to provide credit facilities to corporate customers who wish to maintain relationships with a wide range of banks in order to diversify their sources of funding.

As the Korean economy further develops and new business opportunities arise, more competitors may enter the financial services industry. Recently, banks are beginning to compete for new customers and competition between bank-operated credit card companies and independent card companies may increase substantially. For example, as part of the aforementioned privatization efforts by the Government, Woori Card may be sold to another major credit card company, in which case it is possible that a credit card company comparable to Shinhan Card in terms of asset size and customer base may newly emerge. Furthermore, as online service providers with large-scale user networks, such as Daum Kakao, make significant inroads in providing virtual payment services through a system based on a growing convergence of financial services and technology commonly referred to as *fintech*, competition for online customers is growing not just among commercial banks, but also from online service providers. Accordingly, the commercial banks are facing increasing pressure to upgrade their service platforms to attract and maintain online users, which represents a growing customer base compared to traditional customers who have primarily conducted banking in-person at physical banking branches. In addition, large non-financial institutions, such as mobile telecommunications companies, which on a combined basis service most of the Korean population, may expand entry into the Korean credit card and consumer finance businesses by way of convergence with the existing and future mobile telephone networks. Accordingly, a widespread consumer acceptance of mobile phone payment services in lieu of credit card services could add to competitive threat to the existing credit card service providers, including our credit card subsidiary.

Recently, following the global financial crisis, the Government has subjected Korean financial institutions to stricter regulatory requirements and guidelines in areas of asset quality, capital adequacy, liquidity and residential and other lending practices, which has had a dampening effect on competition. The Financial Services Commission implemented the capital requirements of Basel III, the minimum requirements of which are being phased in sequentially from December 1, 2013 and will become fully effective on January 1, 2019, based on the guidelines set forth in the amended Regulation on the Supervision of the Banking Business and the Detailed Regulation on the Supervision of the Banking Business. In addition, the Financial Services Commission announced its plan to implement Basel III requirements relating to liquidity coverage ratio and countercyclical capital buffer in 2015 and 2016, respectively, among other Basel III requirements. However, there is no assurance that these measures will continue to curb competition or that the Government will not reverse or reduce such measures or introduce other deregulatory measures, which may further intensify competition in the Korean financial services industry.

If we are unable to compete effectively in the changing business and regulatory environment, our profit margin and market share may erode and our future growth opportunities may become limited, which could adversely affect our business, financial condition and results of operations.

***We and our subsidiaries need to maintain our capital ratios above minimum required levels, and the failure to so maintain could result in the suspension of some or all of our operations.***

We and our subsidiaries in Korea are required to maintain specified capital adequacy ratios. For example, effective January 1, 2015, we and our banking subsidiaries in Korea are required to maintain a minimum Tier I capital

adequacy ratio of 6.0%, a common equity Tier I ratio of 4.5% and a BIS ratio of 8.0%. These ratios measure the respective regulatory capital as a percentage of risk-weighted assets on a consolidated basis and are determined based on guidelines of the Financial Services Commission. In addition, our subsidiaries Shinhan



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Card, Shinhan Life Insurance and Shinhan Investment are required to maintain a consolidated adjusted equity capital ratio of 8.0%, a solvency ratio of 100% and a net operating capital ratio of 150%, respectively.

While we and our subsidiaries currently maintain capital adequacy ratios in excess of the respective required regulatory minimum levels, we or our subsidiaries may not be able to continue to satisfy the capital adequacy requirements for a number of reasons, including an increase in risky assets and provisioning expenses, substitution costs related to the disposal of problem loans, declines in the value of securities portfolios, adverse changes in foreign currency exchange rates, changes in the capital ratio requirements, the guidelines regarding the computation of capital ratios, or the framework set by the Basel Committee on Banking Supervision (the Basel Committee) upon which the guidelines of the Financial Services Commission are based, or other adverse developments affecting our asset quality or equity capital.

In December 2010, the Basel Committee issued final rules in respect of (i) a global regulatory framework for more resilient banks and banking systems and (ii) an international framework for liquidity risk measurement, standards and monitoring, which together are commonly referred to as Basel III. The new minimum capital requirements, including the minimum common equity Tier 1 requirement of 4.5% and additional capital conservation buffer requirement of 2.5%, are currently being implemented in phases until January 1, 2019. Additional countercyclical capital buffer requirements are also expected to be phased in starting in 2016, which will range at the discretion of national regulators between 0% and 2.5% of risk-weighted assets. Basel III introduced a minimum leverage ratio requirement that is currently proposed at 3% on a preliminary basis. The Basel Committee issued the full text of Basel III's leverage ratio framework and disclosure in January 2014. Public disclosure of the components of the leverage ratio is required starting January 1, 2015. The final calibration of the leverage ratio and any further adjustments to its definition are currently expected to be completed by 2017 and full compliance therewith is expected to be required beginning January 1, 2018. On January 13, 2011, the Basel Committee issued further minimum capital requirements to ensure that all classes of capital instruments fully absorb losses at the point of non-viability before taxpayers are exposed to loss. Instruments issued on or after January 1, 2013 may only be included in regulatory capital if the new requirements are met. The capital treatment of securities issued prior to this date will be phased out over a ten-year period commencing January 1, 2013.

The Financial Supervisory Service amended the Regulation on the Supervision of the Banking Business to implement the capital requirements of Basel III in Korea under which the new Basel III capital requirements were phased in sequentially from December 2013 and became fully effective in January 2015. Under the amended Regulation on the Supervision of the Banking Business, commercial banks in Korea must meet certain minimum capital requirements with respect to risk-weighted assets. Specifically, effective from December 1, 2013, commercial banks are required to maintain a minimum total capital adequacy (BIS) ratio of 8.0%, a minimum common stock capital ratio of 3.5% and a minimum Tier I capital ratio of 4.5% and, effective from January 1, 2015, commercial banks are required to maintain a minimum total capital adequacy (BIS) ratio of 8.0%, a minimum common stock capital ratio of 4.5% and a minimum Tier 1 capital ratio of 6.0%. Effective January 1, 2015, if any bank fails to satisfy the above requirements, such bank will be subject to prompt corrective measures. In addition to such minimum capital requirements, capital conservation buffer requirements will be phased in sequentially from January 2016, at which time commercial banks will be required to reserve at least a 0.625% capital surcharge in its capital conservation buffer, and from January 2019, at which time commercial banks will be required to maintain a capital conservation buffer of 2.5%. If a commercial bank fails to maintain such capital conservation buffer requirements, such bank will be subject to certain restrictions relating to its use of income, such as distributing dividends and purchasing treasury stock. In addition, under the amended Regulation on the Supervision of the Banking Business, equity securities issued after December 1, 2013 must include a contingent capital feature as required under Basel III's capital requirements. For equity securities issued before December 1, 2013, a certain amount thereof will be derecognized annually as equity securities pursuant to the transitional provisions of such amended regulations. However, equity securities issued after September 12, 2010

containing step-up provisions do not benefit from such transitional provisions and are not recognized as equity securities in their full amount. Accordingly, the Series 12 non-voting redeemable preferred

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shares we issued on April 20, 2011 are not recognized as equity securities. See Item 10.B. Memorandum and Articles of Incorporation Description of Preferred Stock Preferred Stock for more details regarding our Series 12 non-voting redeemable preferred shares.

We and our banking subsidiaries are currently in compliance with Basel III requirements in effect since December 1, 2013. However, there is no assurance that we will continue to be able to do so for whatsoever reason, and if the capital adequacy ratios of us or our subsidiaries were to fall below the required levels, the Financial Services Commission might impose penalties ranging from a warning to suspension or revocation of our or our subsidiaries' business licenses. In order to maintain the capital adequacy ratios above the required levels, we or our subsidiaries may be required to raise additional capital through equity financing, but there is no assurance that we or our subsidiaries will be able to do so on commercially favorable terms or at all and, even if successful, any such capital raising may have a dilutive effect on our shareholders with respect to their interest in us or on us with respect to our interest in our subsidiaries.

***Liquidity, funding management and credit ratings are critical to our ongoing performance.***

Liquidity is essential to our business as a financial intermediary, and we may seek additional funding in the near future to satisfy liquidity needs, meet regulatory requirements, enhance our capital levels or fund the growth of our operations as opportunities arise.

For example, Basel III includes an international framework for liquidity risk measurement, standards and monitoring, as noted above, including a new minimum liquidity standard, known as the liquidity coverage ratio ( LCR ), which is designed to ensure that banks have an adequate stock of unencumbered high quality liquid assets ( HQLA ) that can be easily and speedily converted into cash in the private marketplace to survive a significant stress scenario lasting 30 calendar days. The LCR is computed as (a) the value of a banking organization's HQLA, divided by (b) its total expected net cash outflows over the next 30 calendar days under stress scenarios. The minimum LCR is 100%. In January 2013, the Basel Committee on Bank Supervision released a revised formulation of the LCR, one of two quantitative liquidity measures approved in December 2010 as part of Basel III. The Basel Committee extended the timetable for full phase-in of the LCR to the effect that the minimum LCR has become 60% as of January 1, 2015 and will thereafter rise by an annual increment of 10% so that the minimum LCR will be 100% as of January 1, 2019. In December 2014, the Financial Services Commission promulgated regulations to implement the liquidity requirements of Basel III, including raising the minimum LCR to 80% as of January 1, 2015 and thereafter by an annual increment of 5% so that the minimum LCR for commercial banks in Korea will be 100% as of January 1, 2019.

A substantial part of the liquidity and funding requirements for our banking subsidiaries is met through short-term customer deposits, which typically roll over upon maturity. While the volume of our customer deposits has generally been stable over time, customer deposits have from time to time declined substantially due to the popularity of other, higher-yielding investment opportunities, namely stocks and mutual funds, for example, during times of bullish stock markets. During such times, our banking subsidiaries were required to obtain alternative funding at higher costs. There is no assurance that a similar development will not occur in the future. In addition, in recent years, we have faced increasing pricing competition from our competitors with respect to our deposit products. If we do not continue to offer competitive interest rates to our deposit customers, we may lose their business, which has traditionally provided a stable and low-cost source of funding. In addition, even if we are able to match our competitors' pricing, doing so may result in an increase in our funding costs, which may have an adverse impact on our results of operation.

We and our subsidiaries also raise funds in capital markets and borrow from other financial institutions, the cost of which depends on the market rates and the general availability of credit and the terms of which may limit our ability to pay dividends, make acquisitions or subject us to other restrictive covenants. While we and our subsidiaries are not

currently facing liquidity difficulties in any material respect, if we or our subsidiaries are unable to obtain the funding we need on terms commercially acceptable to us for an extended period of time for whatever reason, we may not be able to ensure our financial viability, meet regulatory requirements, implement our strategies or compete effectively.

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Credit ratings affect the cost and other terms upon which we and our subsidiaries are able to obtain funding. Domestic and international rating agencies regularly evaluate us and our subsidiaries, and their ratings of our and our subsidiaries' long-term debt are based on a number of factors, including our financial strength as well as conditions affecting the financial services industry and the Korean economy in general. There can be no assurance that the rating agencies will maintain our current ratings or outlooks. There is no assurance that Shinhan Bank, Shinhan Card, any of our other major subsidiaries or our holding company will not experience a downgrade in their respective credit ratings and outlooks for reasons related to the general Korean economy or reasons specific to such entity. Any downgrade in the credit ratings and outlooks of us and our subsidiaries will likely increase the cost of our funding, limit our access to capital markets and other borrowings, require us to provide additional credit enhancement in financial transactions, and could increase the amount of regulatory liquidity we will be required to hold when Basel III liquidity requirements become effective, any of which could adversely affect our liquidity, net interest margins and profitability, and in turn, our business, financial condition and results of operations.

***Changes in interest rates, foreign exchange rates, bond and equity prices, and other market factors have affected and will continue to affect our business, results of operation and financial condition.***

The most significant market risks we face are interest rate, foreign exchange and bond and equity price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realized between lending and borrowing costs. Changes in foreign currency exchange rates, particularly in the Korean Won-U.S. Dollar exchange rates, affect the value of our assets and liabilities denominated in foreign currencies, the reported earnings of our non-Korean subsidiaries and income from foreign exchange dealings, and substantial and rapid fluctuations in the exchange rates may cause difficulty in obtaining foreign currency-denominated financing in international financial markets on commercial terms acceptable to us or at all. The performance of financial markets may affect bond and equity prices and, therefore, cause changes in the value of our investment and trading portfolios. While we have implemented risk management systems to mitigate and control these and other market risks to which we are exposed, it is difficult to predict with accuracy changes in economic or market conditions and to anticipate the effects that such changes could have on our business, financial condition and results of operations.

Of particular importance is the change in the base and market interest rates. Since the onset of the global financial crisis in the second half of 2008, Korea, like many other countries, has experienced a low interest rate environment despite some marginal fluctuations, in part due to the Government's policy to stimulate the economy through active rate-lowering measures. Since January 1, 2011, the base interest rate set by the Bank of Korea has remained within the band between 1.75% and 3.25%. In March 2015, the base interest rate was set at a historic low of 1.75%.

Interest rate movements, in terms of magnitude and timing as well as their relative impacts on our assets and liabilities, have a significant impact on our net interest margin and profitability, particularly with respect to our financial products that are sensitive to such movements. For example, if the interest rates applicable to our loans (which are recorded as assets) increase at a slower pace or by a thinner margin than the interest rates applicable to our deposits (which are recorded as liabilities), our net interest margin will shrink and our profitability will be negatively affected. In addition, the relative size and composition of our variable rate loans and deposits (as compared to our fixed rate loans and deposits) may also impact our net interest margin. Furthermore, the difference in the average term of our interest-earning assets (primarily loans) compared to our interest-bearing liabilities (primarily deposits) may also impact our net interest margin. For example, since our deposits tend to have longer terms, on average, than those of our loans, our deposits are on average less sensitive to movements in the base interest rates on which our deposits and loans tend to be pegged, and therefore, a decrease in the base interest rates tends to decrease our net interest margin while an increase in the base interest rates tends to have the opposite effect. While we continually manage our assets and liabilities to minimize our exposure to interest rate volatility, such efforts by us may not mitigate the impact of interest rate volatility in a timely or effective



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manner, and our net interest margin, and in turn our financial condition and results of operations, could suffer significantly.

We cannot assure you when and to what extent the Government will in the future adjust the base interest rate, to which the market interest rate correlate. A decision to adjust the base interest rate is subject to many policy considerations, including the general economic cycle, inflationary levels, interest rates in other economies and foreign currency exchange rates, among others. In general, a decrease in interest rates adversely affects our interest income due to the differential maturity structure for our assets and liabilities as discussed above. Conversely, if there were to be a significant or sustained increase in interest rates, all else being equal, such movement would lead to a decline in the value of traded debt securities and could also raise our funding costs, while reducing loan demand, especially among retail customers. Rising interest rates may therefore require us to re-balance our assets and liabilities in order to minimize the risk of potential mismatches in our asset liability management and to maintain our profitability. In addition, rising interest rates may adversely affect the Korean economy and the financial condition of our corporate and retail borrowers, including holders of our credit cards, which in turn may lead to deterioration of asset quality for our credit portfolio. Since most of our retail and corporate loans bear interest at rates that adjust periodically based on prevailing market rates, a sustained increase in interest rates will increase the funding costs of our borrowers and may adversely affect their ability to make payments on their outstanding loans.

***We may incur losses associated with our counterparty exposures.***

We face the risk that counterparties will be unable to honor contractual obligations to us or our subsidiaries. These parties may default on their obligations to us or our subsidiaries due to bankruptcy, lack of liquidity, operational failure or other reasons. This risk may arise, for example, from entering into swaps or other derivative contracts under which counterparties have obligations to make payments to us or our subsidiaries or in executing currency or other trades that fail to settle at the required time due to non-delivery by the counterparty or systems failure by clearing agents, exchanges, clearing houses or other financial intermediaries. Any realization of counterparty risk may adversely affect our business, operations and financial condition.

**Risks Relating to Our Banking Business*****We have significant exposure to small- and medium-sized enterprises, and financial difficulties experienced by such enterprises may result in a deterioration of our asset quality.***

Our banking activities are conducted primarily through our wholly-owned subsidiary, Shinhan Bank. One of our core banking businesses has historically been and continues to be lending to small- and medium-sized enterprises (as defined in Item 4.B. Business Overview – Our Principal Activities – Corporate and Investment Banking Services – Small- and Medium-sized Enterprises Banking ). Our loans to such enterprises amounted to ₩51,324 billion as of December 31, 2012, ₩55,062 billion as of December 31, 2013 and ₩59,889 billion as of December 31, 2014, representing 25.37%, 26.47% and 26.75%, respectively, of our total loan portfolio as of such dates.

Compared to loans to large corporations, which tend to be better capitalized and weather business downturns with greater ease, or loans to individuals and households, which tend to be secured with homes and with respect to which the borrowers are therefore less willing to default, loans to small- and medium-sized enterprises have historically had a relatively higher delinquency ratio. Many small- and medium-sized enterprises represent sole proprietorships or small businesses dependent on a relatively limited number of suppliers or customers and tend to be affected to a greater extent than large corporate borrowers by fluctuations in the Korean and global economy. In addition, small- and medium-sized enterprises often maintain less sophisticated financial records than large corporate borrowers. Therefore, it is generally more difficult for us to judge the level of risk inherent in lending to these enterprises, as

compared to large corporations. In addition, many small- and medium-sized enterprises are dependent on business relationships with large corporations in Korea, primarily as suppliers.



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Any difficulties encountered by those large corporations would likely hurt the liquidity and financial condition of related small- and medium-sized enterprises, including those to which we have exposure, also resulting in an impairment of their ability to repay loans. As large Korean corporations continue to expand into China and other countries with lower labor costs and other expenses through relocating their production plants and facilities to such countries, such development may have a material adverse impact on such small- and medium-sized enterprises.

Financial difficulties experienced by small- and medium-sized enterprises as a result of, among other things, recent economic difficulties in Korea and globally and aggressive marketing and intense competition among banks to lend to this segment in recent years, coupled with our efforts to counter asset quality deterioration through controlled lending policy, have led to a fluctuation in the asset quality of our loans to this segment. As of December 31, 2012, 2013 and 2014, Shinhan Bank's delinquent loans to small- and medium-sized enterprises were ~~₩487 billion~~, ~~₩320 billion~~ and ~~₩332 billion~~, respectively, representing delinquency ratios (net of charge-offs and loan sales) of 0.89%, 0.55% and 0.53%, respectively. If the ongoing difficulties in the Korean or global economy were to continue or further aggravate, the delinquency ratio for our loans to small- and medium-sized enterprises may rise significantly.

Of particular concern is our significant exposure to enterprises in the real estate and leasing and construction industries. As of December 31, 2014, Shinhan Bank had outstanding loans to the real estate and leasing and construction industries (many of which are small- and medium-sized enterprises) of ~~₩17,639 billion~~ and ~~₩3,148 billion~~, respectively, representing 9.30% and 1.66%, respectively, of its total loan portfolio as of such date. We also have other exposure to borrowers in these sectors of the Korean economy, including extending guarantees for the benefit of such companies and holding debt and equity securities issued by such companies. In addition, Shinhan Bank has exposure to borrowers in the shipbuilding and shipping industries, which have yet to stage a meaningful turnaround.

The enterprises in the real estate development and construction industries in Korea, which are heavily concentrated in the housing market, continue to experience sluggish growth due to stagnant real estate demand and depressed real estate prices, largely due to a combination of excessive supply of residential property, sustained efforts by the Government to stem speculation in the housing market, ongoing economic sluggishness in Korea and globally and the demographic changes in the Korean population. We also have a limited exposure to real estate project financing, particularly by construction companies that have built residential units in provinces outside the metropolitan Seoul area, which have experienced a relatively low rate of pre-sales, the proceeds from which the construction companies primarily rely on as a key source for liquidity and cash flow.

Any of the foregoing developments may result in deterioration in the asset quality of our banking subsidiaries. See Item 4.B. Business Overview Description of Assets and Liabilities Credit Exposures to Companies in Workout and Recovery Proceedings. We have been taking active steps to curtail delinquency among our small- and medium-sized enterprise customers, including by way of strengthening loan application review processes and closely monitoring borrowers in troubled sectors. Despite such efforts, there is no assurance that the delinquency ratio for our loans to small- and medium-sized enterprises will not rise in the future, especially if the Korean economy were to face renewed difficulties and a subsequent deterioration in the liquidity and cash flow of these borrowers. A significant rise in the delinquency ratios among these borrowers would lead to increased charge-offs and higher provisioning and reduced interest and fee income, which would have a material adverse effect on our business, financial condition and results of operations.

***A decline in the value of the collateral securing our loans or our inability to fully realize the collateral value may adversely affect our credit portfolio.***

Most of our mortgage and home equity loans are secured by borrowers' homes, other real estate, other securities and guarantees (which are principally provided by the Government and other financial institutions), and a substantial portion of our corporate loans are also secured, including by real estate. As of December 31,

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2014, the secured portion of Shinhan Bank's loans amounted to ₩88,899 billion, or 55.6% of its total loans. There is no assurance that the collateral value will not materially decline in the future. Shinhan Bank's general policy for mortgage and home equity loans is to lend up to 40% to 70% of the appraised value of the collateral and to periodically re-appraise such collateral. However, in light of the sustained downturn in the real estate market in Korea, the value of the collateral may fall below the outstanding principal balance of the underlying mortgage loans. Borrowers of such under-collateralized mortgages or loans may be forced to pay back all or a portion of such mortgage loans or, if unable to meet the collateral requirement through such repayment, sell the underlying collateral, which sales may lead to a further decline in the price of real estate in general and set off a chain reaction for other borrowers due to the further decline in the value of collateral. Declines in real estate prices reduce the value of the collateral securing our mortgage and home equity loans, and such reduction in the value of collateral may result in our inability to cover the uncollectible portion of our secured loans. A decline in the value of the real estate or other collateral securing our loans, or our inability to obtain additional collateral in the event of such decline, may result in the deterioration of our asset quality and require us to make additional loan loss provisions. In Korea, foreclosure on collateral generally requires a written petition to a Korean court. Foreclosure procedures in Korea generally take seven months to one year from initiation to collection depending on the nature of the collateral, and foreclosure applications may be subject to delays and administrative requirements, which may result in a decrease in the recovery value of such collateral. There can be no assurance that we will be able to realize the full value of collateral as a result of, among others, delays in foreclosure proceedings, defects in the perfection of collateral and general declines in collateral value. Our failure to recover the expected value of collateral could expose us to significant losses.

***Guarantees received in connection with our real estate financing may not provide sufficient coverage.***

Primarily through Shinhan Bank, we, alone or together with other financial institutions, provide financing to real estate development projects, which are concentrated largely in the construction of residential complexes. Developers in Korea commonly use project financing to acquire land and pay for related project development costs. As a market practice, lenders in project financing, including Shinhan Bank, generally receive from general contractors a performance guarantee for the completion of projects by the developers as well as a payment guarantee for the loans raised by a special purpose financing vehicle established by the developers in order to procure the construction orders, as the developers tend to be small and highly leveraged. As of December 31, 2014, the total outstanding amount of Shinhan Bank's real estate project financing-related exposure was approximately ₩1.1 trillion, which represents a significant decrease over the years as Shinhan Bank has actively reduced new exposures in this area in light of the sustained downturn in the Korean real estate market. However, if defaults were to significantly increase under our existing loans to real estate development projects and the general contractors fail to pay the guaranteed amount necessary to cover the amount of our financings, such development may adversely affect our business, financial condition and results of operations.

***A limited portion of our credit exposure is concentrated in a relatively small number of large corporate borrowers, and future financial difficulties experienced by them may have an adverse impact on us.***

Of Shinhan Bank's 20 largest corporate exposures as of December 31, 2014, nine were companies that are or were members of the main debtor groups as identified by the Governor of the Financial Supervisory Service, which are largely comprised of chaebols. As of such date, the total amount of Shinhan Bank's exposures to the main debtor groups was ₩31,225 billion, or 12.8%, of its total exposure. As of that date, Shinhan Bank's single largest outstanding exposure to a main debtor group (mostly comprised of chaebols) amounted to ₩4,375 billion, or 1.8%, of its total exposures. Largely due to the continued stagnation in the shipbuilding and construction industries, current and former member companies of the STX Group, one of the leading conglomerates in Korea, entered into voluntary arrangements with their creditors (including Shinhan Bank) to improve their credit situation, and in October 2013, Keangnam Enterprises Co., Ltd., a construction company in Korea, entered into workout proceedings. In October

2014, Dongbu Steel also entered into a voluntary arrangement with its creditors led by Korea Development Bank, but our exposure to this company remains limited. Partly as a result of our active past efforts to reduce exposure to the shipbuilding and construction sectors, we currently have limited exposure to the aforementioned troubled companies. However, if the credit quality of our exposures to these and

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other large corporations, including those in the main debtor groups, declines, we may be required to record additional loan loss provisions in respect of loans and impairment losses in respect of securities, which would adversely affect our financial condition, results of operations and capital adequacy. We cannot assure you that the allowances we have established against these exposures will be sufficient to cover all future losses arising from such exposures, especially in the case of a prolonged or renewed economic downturn.

As of December 31, 2014, 10 main debtor groups to which Shinhan Bank has credit exposure remained subject to restructuring programs or were otherwise making significant efforts to improve their financial conditions, such as by obtaining intragroup loans and entering into agreements to further improve their capital structures. There is no assurance that there will not be future restructuring with Shinhan Bank's major corporate customers or that such restructuring will not result in significant losses to Shinhan Bank with less than full recovery. In addition, bankruptcies or financial difficulties of large corporations, including *chaebol* groups, may have the adverse ripple effect of triggering delinquencies and impairment of our loans to small- and medium-sized enterprises that supply parts or labor to such corporations. If we experience future losses from our exposures to large corporations, including *chaebol* groups, it may have a material adverse impact on our business, financial condition and results of operations. See Item 4.B. Business Overview Description of Assets and Liabilities Loans Loan Portfolio Exposure to Main Debtor Groups.

***Any deterioration in the asset quality of our guarantees and acceptances will likely have a material adverse effect on our financial condition and results of operations.***

In the normal course of banking activities, we make various commitments and incur certain contingent liabilities in the form of guarantees and acceptances. Financial guarantees, which are contracts that require us to make specified payments to reimburse the beneficiary of the guarantee for a loss such beneficiary incurs because the debtor in respect of which the guarantee is given fails to make payments when due in accordance with the terms of the relevant debt instrument, are recognized initially at fair value, and such initial fair value is amortized over the life of the financial guarantee. Other guarantees are recorded as off-balance sheet items in the footnotes to our financial statements and those guarantees that we have confirmed to make payments are recorded on the statements of financial position. As of December 31, 2014, we had aggregate guarantees and acceptances of ₩15,110 billion, for which we provided allowances for losses of ₩107 billion. Such guarantees and acceptances include refund guarantees provided by us to shipbuilding companies, which involve guaranteeing a refund payment of the initial cash payment (typically 25% of the contract amount for ship orders) received by shipbuilders from buyers in the event that such shipbuilders are unable to deliver ships in time or otherwise default under shipbuilding contracts. Small- and medium-sized shipbuilding companies continue to face financial difficulties due to the sluggishness of the global economy and the resulting slowdown in shipbuilding orders, which has increased the risk that they may default on their shipbuilding contracts and we may have to make payments under the refund guarantees. The refund guarantees provided by us to small- and medium-sized shipbuilding companies amounted to approximately ₩83 billion as of December 31, 2014. If there is significant deterioration in the quality of assets underlying our guarantees and acceptances, our allowances may be insufficient to cover actual losses resulting in respect of these liabilities, or the losses we incur on the relevant guarantees and acceptances may be larger than the outstanding principal amount of the underlying loans.

**Risks Relating to Our Credit Card Business**

***Future changes in market conditions as well as other factors, such as stricter regulation, may lead to reduced revenues and deterioration in the asset quality of credit card receivables.***

As of December 31, 2012, 2013 and 2014, Shinhan Card's interest-earning credit card assets amounted to ₩20,027 billion, ₩19,626 billion and ₩20,550 billion, respectively. Our large exposure to credit card and other consumer debt

means that we are exposed to changes in economic conditions affecting Korean consumers in general. For example, a rise in unemployment, an increase in interest rates, a downturn in the real estate market, or a general contraction or other difficulties affecting the Korean economy may lead Korean consumers to reduce spending (a substantial portion of which is conducted through credit card transactions), which in turn leads to

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reduced earnings for our credit card business, as well as to higher default rates on credit card loans, deterioration in the quality of our credit card assets and increased difficulties in recovering written-off assets from which a significant portion of Shinhan Card's revenues is derived. Any of these developments could have a material adverse effect on our business, financial condition and results of operations.

Increasing consumer and corporate spending and borrowing on our card products and growth in card lending balances depend in part on Shinhan Card's ability to develop and issue new or enhanced card and prepaid products and increase revenue from such products and services, as well as the level of discretionary income among our cardholders, which is largely affected by macroeconomic factors beyond our control. In addition, credit card companies in Korea, including Shinhan Card, may not be able to enjoy any rapid growth in revenue over the long term due to the maturing nature of the credit card industry, in part due to oversaturation of credit card service providers. Shinhan Card's future earnings and profitability also depend on its ability to attract new cardholders, reduce cardholder attrition, increase merchant coverage and capture a greater share of customers' total credit card spending in Korea and overseas. Shinhan Card may not be able to manage and expand cardholder benefits in a cost-effective manner or contain the growth of marketing, promotion and reward expenses to a commercially reasonable level. If Shinhan Card is not successful in increasing customer spending, maintaining or expanding its market position and asset growth, or containing costs or cardholder benefits, its financial condition, results of operations and cash flow could be negatively affected.

In addition, Government regulations aimed at protecting small- and medium-sized enterprises, such as the reduction of fees chargeable to small- and medium-sized merchants, may have a material adverse effect on our revenues from Shinhan Card. In January 2012, the Government expanded the definition of a small- and medium-sized merchant to include those with annual sales of up to ₩200 million and effective September 2012, lowered fees chargeable to such merchants from 1.8% to 1.5% with respect to credit cards. In 2013, the Government also implemented measures regulating marketing costs in order to control excessive marketing campaigns and curtail undue marketing expenses, which had the effect of impeding revenue growth for credit card companies, but also reduced or slowed the growth in their marketing expenses. In addition, effective December 2013, the Government introduced guidelines to curb the interest rates that credit card companies, including Shinhan Card, may charge on card loans and cash advances. Furthermore, the Government also provides tax incentives, among others, for the use of check cards (where the amounts paid with check cards are instantly debited from the customer's bank accounts) to encourage the use of check cards in lieu of credit cards in an attempt to preempt a potential rise in delinquency among credit card users, and if check cards are widely used in lieu of credit cards, this would reduce interest income from credit cards, which generally have a longer repayment period than that of check cards, and may have an adverse impact on Shinhan Card's revenues and results of operations.

## **Risks Relating to Our Other Businesses**

*We may incur significant losses from our investments and, to a lesser extent, trading activities due to market fluctuations.*

We enter into and maintain large investment positions in fixed income products, primarily through our treasury and investment operations. We describe these activities in Item 4.B. Business Overview Our Principal Activities

Corporate and Investment Banking Services. We also maintain smaller trading positions, including equity and equity-linked securities and derivative financial instruments as part of our operations. Taking these positions entails making assessments about financial market conditions and trends. The revenues and profits we derive from many of these positions and related transactions are dependent on market prices, which are beyond our control. When we own assets such as debt or equity securities, a decline in market prices, for example, as a result of fluctuating market interest rates or stock market indices, can expose us to trading and valuation losses. If market prices move in a way that we have not anticipated, we may experience losses. In addition, when markets are volatile and subject to rapid

changes in price directions, the actual market prices may be contrary to our assessments and lead to lower than anticipated revenues or profits, or even result in losses, with respect to the related transactions and positions.



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***We may generate losses from our brokerage and other commission- and fee-based business.***

We, through our investment and other subsidiaries, currently provide, and seek to expand the offerings of, brokerage and other commission- and fee-based services. Downturns in stock markets typically lead to a decline in the volume of transactions that we execute for our customers and, therefore, a decline in our non-interest revenues. In addition, because the fees that we charge for managing our clients' portfolios are often based on the size of the assets under management, a downturn in the stock market, which has the effect of reducing the value of our clients' portfolios or increasing the amount of withdrawals, also generally reduces the fees we receive from our securities brokerage, trust account management and other asset management services. Even in the absence of a market downturn, below-market performance by our securities, trust account or asset management subsidiaries may result in increased withdrawals and reduced cash inflows, which would reduce the revenue we receive from these businesses. In addition, protracted declines in asset prices can reduce liquidity for assets held by us and lead to material losses if we cannot close out or otherwise dispose of deteriorating positions in a timely way or at commercially reasonable prices.

**Other Risks Relating to Us as the Holding Company**

***Our ability to continue to pay dividends and service debt will depend on the level of profits and cash flows of our subsidiaries.***

We are a financial holding company with minimal operating assets other than the shares of our subsidiaries. Our primary source of funding and cash flow is dividends from, or disposition of our interests in, our subsidiaries or our cash resources, most of which are currently the result of borrowings. Since our principal assets are the outstanding capital stock of our subsidiaries, our ability to pay dividends on our common and preferred shares and service debt will mainly depend on the dividend payments from our subsidiaries.

Companies in Korea are subject to certain legal and regulatory restrictions with respect to payment of dividends. For example, under the Korean Commercial Code, dividends may only be paid out of distributable income, which is calculated by subtracting the aggregate amount of a company's paid-in capital and certain mandatory legal reserves from its net assets, in each case as of the end of the prior fiscal year. In addition, financial companies in Korea, including banks, credit card companies, securities companies and life insurers, such as our subsidiaries, must meet minimum capital requirements and capital adequacy ratios applicable to their respective industries before dividends can be paid. For example, under the Banking Act, a bank is required to credit at least 10% of its net profit to a legal reserve each time it pays dividends on distributable income until such time when this reserve equals the amount of its total paid-in capital, and under the Banking Act, the Specialized Credit Financial Business Act and the regulations promulgated by the Financial Services Commission, if a bank or a credit card company fails to meet its required capital adequacy ratio or is otherwise subject to the management improvement measures imposed by the Financial Services Commission, then the Financial Services Commission may restrict the declaration and payment of dividend by such a bank or credit card company. In addition, if our or our subsidiaries' capital adequacy ratios fall below the required levels, our ability to pay dividends may be restricted by the Financial Services Commission.

***Damage to our reputation could harm our business.***

We are one of the largest and most influential financial institutions in Korea by virtue of our financial track records, market share and the size of our operations and customer base. Our reputation is critical to maintaining our relationships with clients, investors, regulators and the general public. Our reputation can be damaged in numerous ways, including, among others, employee misconduct (including embezzlement), cyber or other security breaches, litigation, compliance failures, corporate governance issues, failure to properly address potential conflicts of interest, the activities of customers and counterparties over which we have limited or no control, prolonged or exacting

scrutiny from regulatory authorities and customers regarding our trade practices, or uncertainty about our financial soundness and our reliability. If we are unable to prevent or properly address these concerns, we could lose our existing or prospective customers and investors, which could adversely affect our business, financial condition and results of operations.

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In the course of our operations, we must manage a number of risks, such as credit risks, market risks and operational risks. Although we devote significant resources to developing and improving our risk management policies and procedures and expect to continue to do so in the future, our risk management practices may not be fully effective at all times in eliminating or mitigating risk exposures in all market environments or against all types of risk, including risks that are unidentified or unanticipated. For example, from time to time, a limited number of our and our subsidiaries' personnel have engaged in embezzlement of substantial amounts for an extended period of time before such activities were detected by our risk management systems. In response to these incidents, we have strengthened our internal control procedures by, among others, implementing a real-time monitoring system, but there is no assurance that such measures will be sufficient to prevent similar employee misconducts in the future. Management of credit, market and operational risk requires, among others, policies and procedures to record properly and verify a large number of transactions and events, and we cannot assure you that these policies and procedures will prove to be fully effective at all times against all the risks we face.

***Legal claims and regulatory risks arise in the conduct of our business.***

In the ordinary course of our business, we are subject to regulatory oversight and potential legal and administrative liability risk. We are also subject to a variety of other claims, disputes, legal proceedings and government investigations in Korea and other jurisdictions where we are active. These types of proceedings expose us to substantial monetary damages and legal defense costs, injunctive relief, criminal and civil penalties and the potential for regulatory restrictions on our businesses. The outcome of these matters cannot be predicted and they could adversely affect our future business.

Shinhan Bank, like many other commercial banks in Korea, is currently subject to litigation in relation to investment products known as KIKOs. KIKOs, which stands for knock-in knock-out, are foreign currency derivative products under the terms of which the seller is obligated to pay the buyer a certain amount if the Korean Won appreciates beyond a certain level and the buyer is obligated to pay the seller a certain amount if the Korean Won depreciates beyond a certain level. Intended as a hedging instrument, these products were sold to mostly small businesses primarily prior to the onset of the global financial crisis in 2008, but when the Korean Won significantly and suddenly depreciated during the global financial crisis, the investors became obligated to pay a substantial sum to the banks, including Shinhan Bank. Subsequently, the investors brought suit to nullify the contracts on grounds of imperfect sale alleging failure on the part of the selling banks to fully disclose the associated risk. As of December 31, 2014, the courts had conclusively found in our favor in 45 of 54 KIKO-related cases and at least partially against us in the remaining nine cases. As of December 31, 2014, seven KIKO-related cases were in proceeding for which the aggregate amount of claims in dispute was ₩46.6 billion and we set aside ₩6.1 billion as allowance in respect of such claims. See Item 8.A. Consolidated Statements and Other Financial Information Legal Proceedings for more information on the legal and regulatory proceedings currently pending against us. While it is difficult to predict the outcome of each lawsuit against us, as it will ultimately depend on the specific facts and circumstances underlying such lawsuit, if the courts rule against us, the lawsuits may have a material adverse effect on our business, financial condition and results of operations.

While we plan to rigorously defend our positions in the foregoing lawsuits, it is difficult to predict the final outcome of litigation. The total amount in dispute may increase during the course of litigation and other lawsuits may be brought against us based on similar allegations. Accordingly, these lawsuits, especially if the courts finally rule against us, may have a material adverse effect on our business, financial condition and results of operations. In addition, while in response to the past or current claims or in order to prevent future legal claims we have implemented extensive employee training and other operational procedures to provide adequate disclosure, prevent

unfair inducement and otherwise comply with all relevant laws and regulations, we cannot assure you that, despite due training and other preventive measures, all of our employees in charge of such sales have not breached disclosure requirements, engaged in unfair inducement or committed similar acts or will not do the same in the future and, as a result, we may face additional claims or litigation in the future, which may have a material adverse effect on our business, reputation, financial condition and results of operations.

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**Table of Contents*****We may experience disruptions, delays and other difficulties relating to our information technology systems.***

We rely on our information technology systems to seamlessly provide our wide-ranging financial services as well as for our daily operations, including billing, online and offline financial transactions settlement and record keeping. We continually upgrade, and make substantial expenditures to upgrade, our group-wide information technology system, including in relation to customer data-sharing and other customer relations management systems, particularly in light of the heightened cyber security risks from advances in technology. Despite our best efforts, however, we may experience disruptions, delays, cyber or other security breaches or other difficulties relating to our information technology systems, and may not timely upgrade our systems as currently planned. Any of these developments may have an adverse effect on our business, particularly if our customers perceive us to not be providing the best-in-class cyber security systems and failing to timely and fully rectify any glitches in our information technology systems.

***Our activities are subject to cyber security risk.***

Our activities have been, and will continue to be, subject to an increasing risk of cyber-attacks, the nature of which is continually evolving. Cyber security risks include unauthorized access, through system-wide hacking or other means, to privileged and sensitive customer information, including passwords and account information, and illegal use thereof. The cyber security risk is generally on the rise as a growing number of our customers increasingly rely on our Internet- and mobile phone-based banking services for various types of financial transactions, the public is developing heightened awareness about the importance of keeping their personal data private and the financial regulators are placing greater emphasis on personal data protection by financial service providers. While we vigilantly protect customer data through encryption and other security programs, there is no assurance that such data will not be subject to future security breaches. We have made substantial investments to build and upgrade our systems and defenses to address the growing threats from cyber-attacks which are increasingly becoming sophisticated based on evolving technology.

For example, in December 2013 it was reported that there was a leakage of personal information of approximately 130,000 customers of Standard Chartered Bank and Citibank in Korea, which leakage was attributed to a third party sub-contractor in the case of Standard Chartered Bank, and an employee in the case of Citibank. In addition, in January 2014, it was reported that there was a leakage of personal information of approximately 100 million customers of NH Card, Lotte Card and KB Card in Korea due to illegal access to such information by an employee of a third party credit information company in the course of developing information technology programs for these three credit card companies, following which the regulatory authorities imposed a brief suspension on telemarketing for all financial institutions in the beginning of 2014. In March 2013, we experienced a temporary interruption in providing online financial services due to large-scale cyber-attacks on the security systems of major broadcasting networks and financial institutions in Korea by sources that have yet to be identified. While the interruption of our online financial services lasted approximately 90 minutes, after which our online system resumed without further malfunction, we do not believe such incident resulted in any material loss, loss of customer information or other sensitive data or unauthorized financial transactions. The Financial Supervisory Service conducted an investigation into the incident and found that Shinhan Bank and Jeju Bank had not properly maintained their information technology administrator accounts and vaccine servers. As a result, in December 2013, the Financial Supervisory Service notified Shinhan Bank and Jeju Bank of an institutional caution (which does not give rise to significant sanctions unlike in the case of repeated institutional warnings), in December 2013 against Shinhan Bank and Jeju Bank and imposed disciplinary actions against five of Shinhan Bank's employees and three of Jeju Bank's employees. In response to the Financial Supervisory Service's findings, Shinhan Bank and Jeju Bank adopted additional safety measures, including total segregation between their internal and external networks and enhancements to their security and vaccine programs.

In order to minimize the risk of security breaches related to customer and our other proprietary information, we have taken a series of group-wide preventive measures, such as the adoption and implementation of a best-in-class information security system and reinforcement of internal control measures, and we have not experienced any similar large scale leakage of customer information. We are also fully committed to maintaining the highest

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standards of cyber security and consumer protection measures and upgrading them continually. We have implemented the ISO 27001-certified security management system for us and all our subsidiaries, and we are currently in the process of obtaining the Information Security Management System certification for us and all our subsidiaries. We believe such certifications represent third-party validations that we are in compliance with best-in-class international standards on matters of information security. Our security management system continuously monitors for signs of potential cyber-attacks or other security breaches, and is designed to provide early warning alerts to enable prompt action on our part. We also provide intensive training to our information technology staff and our other employees on cyber security and other security breaches and have adopted advanced security infrastructure (including through hiring a highly competent team of information security experts) for online financial services such as mandatory website certification and keyboard security functions. In addition, in compliance with applicable regulations we currently carry insurance to cover cyber security breaches up to ₩2 billion in relation to our banking business and up to ₩3 billion in the aggregate and up to ₩1 billion per incident for our securities investment business and have set aside a reserve of ₩1 billion for our credit card business. In addition, in light of the growing use of smartphones and other mobile devices to access financial services, we have implemented security measures (including encryptions and service terminal monitoring) to provide a secure mobile banking service as well as to prevent illegal leakage or sharing of customer data and otherwise enhance customer privacy. We are also keenly aware of the litigation and regulatory sanctions risks that may arise from security breaches and are aggressively reinforcing a groupwide culture that stresses safety and good custodianship as among our highest priorities. Furthermore, we are actively taking steps to implement preventive and other steps recommended or required by the regulatory authorities in relation to actual and potential financial scams. However, major financial institutions in Korea, including us, have fallen victim to cyber security attacks in the past, and given the unpredictable and continually evolving nature of cyber security threats due to advances in technology or other reasons, we cannot assure you that, notwithstanding our best efforts at maintaining the best-in-class cyber security systems, we will not be vulnerable to major cyber security attacks in the future. In addition, there can be no assurance that we will not experience a leakage of customer information or other security breaches in the future as a result of illegal activities by its internal employees, outside consultants or hackers, or otherwise.

If a cyber or other security breach were to happen with respect to us or any of our subsidiaries, it may result in litigation by affected customers or other third parties (including class actions), compensation for any losses suffered by victims of cyber security attacks, reputational damage, loss of customers, heightened regulatory scrutiny and related sanctions, compliance with the present and future regulatory restrictions, and other costs related to damage control, reparation and reinforcement of information security systems, any of which may have a material adverse effect on our business, results of operation and financial condition.

***Our customers may become victims to voice phishing or other financial scams, for which we may be required to make monetary compensation and suffer damage to our business and reputation.***

In recent years, financial scams known as voice phishing have been on the rise in Korea. While voice phishing takes many forms and has evolved over time in terms of sophistication, it typically involves the scammer making a phone call to a victim under false pretenses (for example, the scammer pretending to be a member of law enforcement, an employee of a financial institution or even an abductor of the victim's child) and luring the victim to transfer money to an untraceable account controlled by the scammer. More recently, voice phishing has increasingly taken the form of the scammer hacking or otherwise wrongfully obtaining personal financial information of the victim (such as credit card numbers or Internet banking login information) over the telephone or other means and illegally using such information to obtain credit card loans or cash advances through automated telephone banking or Internet banking. Reportedly, a substantial number of such scammers belong to international criminal syndicates with bases overseas, such as China, with operatives in Korea.

In response to the growing incidents of voice phishing, regulatory authorities have undertaken a number of steps to protect consumers against voice phishing and other financial scams. There is no assurance, however, that the regulatory activities will have the desired effect of substantially eradicating or even containing the incidents



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of voice phishing or other financial scams. For example, following an investigation in November and December 2011 of major credit card companies, including Shinhan Card, as to their compliance with regulations on card loan-related voice phishing and the scope of damage suffered by customers as a result of voice phishing, the Financial Supervisory Service issued a number of guidelines for credit companies to comply with in order to minimize damage from voice phishing, including, among others, (i) strengthening identity verification procedures for card loan applications that are made online or through the automated response system, (ii) delaying the timing of loan payout by a few hours following the approval of card loan application, and (iii) giving an option to customers to block card loan applications. In May 2012, Shinhan Card completed all necessary steps to fully comply with these additional guidelines and has been in full compliance since then.

Although the financial institutions are often not legally at fault for the damage suffered by victims of voice phishing, the compensation scheme was adopted largely in consideration of social responsibility among financial institutions and that the financial institutions were not required to, and therefore in many instances did not, confirm the personal identity of the card loan or cash advance applicants prior to the adoption of such scheme. On December 8, 2011, Shinhan Card began implementing a mandatory outcall procedure to verify the personal identity of applicants for card loans and cash advances if not requested in person. In January 2012, financial institutions, the Financial Supervisory Service, the police and other related institutions formed a joint committee to prevent voice phishing incidents and implemented preventive measures such as enforcing a 10 minute delay for withdrawal of credit card loans of ₩3 million or more from an automated teller machine.

Partly as a result of these efforts, the claims that Shinhan Card received in 2014 in relation to voice phishing amounted only to an aggregate amount of ₩0.31 billion from 81 customers, for which Shinhan Card reserved as other provisioning ₩0.11 billion to cover its potential liability. Accordingly, we do not believe that the currently outstanding claims in relation to voice phishing will have a material adverse impact on our business, financial condition or results of operations. Additionally, other than voice phishing incidents and the recent cyber security attacks as discussed above, we have not experienced any material security breaches in the past. However, given continual advances in technology and the increasing sophistication of the financial scammers, there is no assurance that we will be able to prevent future financial scams, or that the frequency and scope of financial scams will not rise. If financial scams involving us and our subsidiaries were to continue or to become more prevalent, it may result in compensation for any losses suffered by victims thereof, reputational damage, loss of customers, heightened regulatory scrutiny and related sanctions, compliance with the present and future regulatory restrictions, and other costs related to damage control, reparation and reinforcement of our preventive measures, any of which may have a material adverse effect on our business, results of operation and financial condition.

**Risks Relating to Law, Regulation and Government Policy**

***We are a heavily regulated entity and operate in a legal and regulatory environment that is subject to change, and violations could result in penalties and other regulatory actions.***

As a financial services provider, we are subject to a number of regulations that are designed to maintain the safety and soundness of Korea's financial system, to ensure our compliance with economic and other obligations and to limit our risk exposure. These regulations may limit our activities, and changes in these regulations may increase our costs of doing business. Regulatory agencies frequently review regulations relating to our business and implement new regulatory measures, including increasing the minimum required provisioning levels or capital adequacy ratios applicable to us and our subsidiaries from time to time. We expect the regulatory environment in which we operate to continue to change. Changes in regulations applicable to us, our subsidiaries and our or their business or changes in the implementation or interpretation of such regulations could affect us and our subsidiaries in unpredictable ways and could adversely affect our business, financial condition and results of operations.

In addition, upon implementation of the proposed Financial Consumer Protection Act (currently pending at the National Assembly for a vote), customers of financial services will be entitled to heightened investor

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protection measures, including additional remedies in the case of imperfect sales of financial products based on inadequate disclosure or unfair inducement, such as mandatory compensatory damages, right of rescission, class action eligibility and double damages in case of a statutory violation. We may also become subject to other restrictions on our operations as a result of future changes in laws and regulations, including more stringent liquidity and capital requirements under Basel III, which will be adopted in phases in Korea in consideration of, among others, the pace and scope of international adoption of such requirements. Any of these regulatory developments may have a material adverse effect on our ability to expand operations or adequately manage our risks and liabilities. For further details on the principal laws and regulations applicable to us as a holding company and our principal subsidiaries, see Item 4.B. Business Overview – Supervision and Regulation.

In addition, violations of law and regulations could expose us to significant liabilities and sanctions. For example, the Financial Supervisory Service conducts periodic audits on us and, from time to time, we have received institutional warnings from the Financial Supervisory Service. If the Financial Supervisory Service determines as part of such audit or otherwise that our financial condition, including the financial conditions of our operating subsidiaries, is unsound or that we have violated applicable law or regulations, including Financial Services Commission orders, or if we or our operating subsidiaries fail to meet the applicable requisite capital ratio or the capital adequacy ratio, as the case may be, set forth under Korean law, the Financial Services Commission may order, among others, at the level of the holding company or that of the relevant subsidiary, capital increases or reductions, suspension of officers from performing their duties and appointment of custodians, stock cancellations, consolidations, transfers of business, sales of assets, closures of branch offices, mergers with other financial institutions and/or suspensions of a part or all of our business operations. From time to time, our subsidiaries, including Shinhan Bank and Shinhan Card, have been subject to investigations and/or sanctions from the Financial Supervisory Service. See Item 8.A. Consolidated Statements and Other Financial Information – Legal Proceedings. Any such investigation and/or sanctions could adversely impact our reputation, business, results of operation and financial condition.

***The Korean government may encourage targeted lending to certain sectors in furtherance of policy objectives, and we may take this factor into account.***

The Government has encouraged and may in the future encourage targeted lending to certain types of enterprises and individuals in furtherance of government initiatives. The Government, through its regulatory bodies such as the Financial Services Commission, from time to time announces lending policies to encourage Korean banks and financial institutions, including us and our subsidiaries, to lend to particular industries, business groups or customer segments, and, in certain cases, has provided lower cost funding through loans made by the Bank of Korea for further lending to specific customer segments. For example, the Government has taken and is taking various initiatives to support small- and medium-sized enterprises and low-income individuals, who were disproportionately affected by the downturn in the Korean and global economy in the late 2000s and have yet to fully recover.

In addition, the financial regulators have adopted several measures designed to improve certain lending practices of the commercial banks which practices were perceived as having an unduly prohibitive effect on extending loans to small- to medium-sized enterprises. Moreover, as a way of supporting the Government's initiative to assist promising start-ups and venture companies, in February 2015 the financial regulators announced that they would encourage the banks in Korea to increase lending to technology companies in the small- to medium-sized enterprise segment by an annual target of ₩20 trillion and to enhance technology-related credit review capabilities. Furthermore, in February 2014, the Financial Services Commission announced that it plans to increase fixed interest rate housing loans and installment principal repayment-based housing loans each as a proportion of the housing loans extended by commercial banks (which loans have historically been, for the most part, variable interest rate loans with the entire principal being repaid at maturity, which is usually rolled over on an annual basis). According to this plan, the target proportion for the fixed interest rate, installment principal repayment housing loans was 20% by the end of 2014, 25%

by the end of 2015, 30% by the end of 2016 and 40% by the end of 2017. In addition, an expanded tax deduction limit for interest repayment will be

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granted for loans with maturity of 10 years or more (compared to 15 years or more prior to this plan). According to the assessment by the Financial Services Commission in January 2015 of the restructured housing loans by banks in Korea as of December 31, 2014, fixed interest rate and installment principal repayment-based housing loans accounted for 23.6% and 26.5%, respectively, exceeding target proportions for 2014. The Financial Services Commission announced that it would continue to examine whether banks meet their targets on an annual basis.

Moreover, in furtherance of the policy to expand the proportion of fixed rate housing loans, the Financial Services Commission implemented, from March 24 to March 27, 2015 and also from March 30 to April 3, 2015, a Relief Debt Conversion program under which borrowers of eligible housing loans (namely, loans that have been in existence for one year or more since the original loan date, with no delinquency in the past six months, with principal amounts of ₩500 million or less and for houses valued at ₩900 million or less that are on a floating rate basis and/or an interest payment only basis) might convert such loans to new fixed rate loans in respect of which the borrowers would be required to repay the principal and interest in installment for a term of 10, 15, 20 or 30 years without a grace period, provided that the new loans pass the loan-to-value ratio of 70% and the debt-to-income ratio of 60%. The borrowers were allowed to convert the original loans only at the banks that extended such loans. The banks holding the newly converted fixed rate loans are required to sell such loans to Korea Housing Finance Corporation, a government-controlled entity, which will then securitize such loans and issue mortgage-backed securities (backed by such loans) to be purchased by the banks who sold the loans in proportion to the amounts of the loans sold, and the banks will be required to hold such securities for a period of one year, after which the bank can sell or dispose of such securities in the market or otherwise. According to the Financial Supervisory Commission, under this program, approximately 345,000 borrowers converted loans in the aggregate amount of ₩33.9 trillion to fixed rate loans, of which Shinhan Bank accounted for approximately 13.1%. In the event that market interest rates increase from those applicable during this program's implementation in March and April 2015, we may experience valuation or realization losses on the mortgage-backed securities to be held by Shinhan Bank or, depending on prevailing market conditions, difficulties in selling the mortgage backed securities in the market or otherwise in amounts or at prices commercially reasonable to us. Any of these developments could adversely affect our results of operation and financial condition.

We, on a voluntary basis, may factor the existence of such policies and encouragements into consideration in making loans although the ultimate decision whether to make loans remains with us and is made based on our internal credit approval procedures and risk management systems independently of Government policies. In addition, in tandem with providing additional loans to small- and medium-sized enterprises and low-income individuals, Shinhan Bank takes active steps to mitigate the potential adverse impacts from making bad loans to enterprises or individuals with high risk profiles as a result of such arrangements, such as by strengthening its loan review and post-lending monitoring processes. However, we cannot assure you that future government-led initiatives, including those undertaken in order to spur the overall economy, encourage the growth of targeted industries and/or provide relief to certain segments of the economy in distress (such as small- to medium-sized enterprises in general or in certain industry sectors and low-income households and individuals who, on average, have weaker credit profiles), and our actions in relation to such government initiatives will not result in lending decisions that are riskier and less commercially desirable, which might in turn result in enhanced difficulties for us in terms of risk management, deterioration of our asset quality and reduced earnings, compared to what would have been in the absence of such initiatives. Such developments may have an adverse effect on our business, financial condition and results of operation.

***The Korean government may also encourage us to make investments in certain institutions in furtherance of policy objectives, and we may not recoup our investments therein in a timely or otherwise commercially reasonable manner.***

In addition to targeted lending, the Government may from time to time encourage or request the financial institutions in Korea, including us and our subsidiaries, to make investments in or provide other forms of



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financial support to certain institutions in furtherance of the Government's policy objectives. In response thereto, we have made and will continue to make the ultimate decision on whether, how and to what extent we will comply with such encouragements or requests based on our internal risk assessment and in accordance with our risk management systems and policies. At the same time, as a leading member of the financial service industry in Korea and as a responsible corporate citizen we will also fully give due consideration to such encouragements or requests from the Government, especially in relation to the long-term benefit arising from furthering the policy objective of maintaining a sound financial system, even if complying with such requests may involve additional short-term costs and risks to a limited extent.

For example, in order to reduce non-performing assets from mostly real-estate project financings primarily affecting mostly lower-tier commercial banks and savings banks, in June 2011, the Government established the United PF 1<sup>st</sup> Recovery Private Equity Fund (the Fund), a joint-stock private equity fund sponsored by United Asset Management Company Ltd. (UAMCO), a government-invested enterprise and the largest purchaser in Korea of non-performing financial assets generally, and eight major policy and commercial banks. While Shinhan Bank holds a 10.65% equity interest in the Fund, Shinhan Bank, like the other seven banks, is a limited partner and does not have any involvement in the management or day-to-day operations of the Fund. Such management and operational activities are handled by UAMCO, a general partner designated as the managing partner under the Fund's articles of organization. UAMCO is a limited liability company whose shareholders are the six banks that have made capital contributions to the Fund (namely, Shinhan Bank, Kookmin Bank, Hana Bank, Nonghyup Bank, Industrial Bank of Korea and Woori Bank) acts within the scope of delegated authorities as expressly set out in the Fund's articles of incorporation, namely in relation to asset and liabilities management, investment decisions and distributions of the Fund's assets, among others. Under the Fund's articles of organization, the activities of the general partner are subject to supervision by an advisory committee consisting of representatives of each of the limited partners (which may not be a general partner), and the advisory committee may express a non-binding view on the activities of the managing partner. If the managing partner breaches law or material articles of the Fund's articles of incorporation, the advisory committee, with the consent from members representing two-thirds or more of the equity interests in the Fund, may suspend such managing partner's activities relating to the operation and management of the Fund.

The Fund is funded with capital contributions and loans from the aforesaid sponsors in the aggregate amount of ₩1,828 billion (consisting of ₩1,400 billion in capital contributions and ₩428 billion in loans) as of December 31, 2014, of which Shinhan Bank is obligated to make capital contributions up to ₩149 billion (representing a 10.65% equity interest in the Fund in the form of common shares) and loans of ₩19.4 billion (representing 4.5% of the total loans made by the sponsors) as of December 31, 2014. While Shinhan Bank, together with other sponsors, may be requested to make, on a prorated basis based on their relative shareholdings, additional capital contributions and loans upon further purchase by the Fund of non-performing assets from project financings, Shinhan Bank had made capital contributions in the aggregate amount of ₩118.7 billion and fulfilled its capital contribution obligations as of December 31, 2014. The capital contributions made by Shinhan Bank to-date have not been subject to impairment since the underlying assets of the Fund, which primarily consist of impaired loans, are purchased at fair value, and profits have subsequently been realized thereon either in the form of recovery from enhanced collection measures or capital gains upon resale thereof. Shinhan Bank currently does not plan to make additional capital contributions. The terms of the loans, including the interest rate and redemption provisions, are subject to further negotiation among the sponsors.

The objective of the Fund is to purchase non-performing assets from project financing companies, professionally manage such assets and later sell them at a profit once these assets have normalized. By doing so, the Fund is expected to enhance the asset quality of financial institutions with significant exposure to unsound project financings by transferring a part of such exposure from such institutions to the Fund, as well as help to normalize the project financing industry. The Fund is not backed by any government guarantee, and the Fund operates based on mutual

agreement of the sponsors. The term of the Fund is five years, which may be extended at a general meeting of the sponsors. Upon liquidation of the Fund, each sponsor will be entitled to a share in the net assets of the Fund at the time of liquidation in proportion to their respective contributions to the Fund.



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Since the establishment of the Fund in June 2011 and up to December 31, 2014, Shinhan Bank had sold non-performing project financing assets in the aggregate amount of ₩179.1 billion to the Fund and recognized from such sales an aggregate loss of ₩56.2 billion before applying allowance for loan losses allocated to such assets and an aggregate profit of ₩7.7 billion after applying allowance for loan losses allocated to such assets. Subject to market conditions, Shinhan Bank may sell additional non-performing project financing assets to the Fund and use all or part of the proceeds for its future capital contribution or loan requirements. However, given the generally poor asset quality of its non-performing project financing assets, there is no assurance that Shinhan Bank will be able to sell such assets held by it on commercially reasonable terms or that the Fund will be able to attain its objective of selling the purchased project financing assets at a profit, in which case Shinhan Bank may not be able to recoup its investment in, or be repaid the loans to, the Fund fully or at all. There is no assurance that in furtherance of similar or other policy objectives, the Government may not request or otherwise encourage financial institutions in Korea, including us and our subsidiaries, to provide similar or other investments or provide other financial support for which we are not duly compensated or otherwise take up additional risk that we would not normally have undertaken, which may have an adverse effect on our business, results of operation and financial condition.

***The level and scope of government oversight of our retail lending business, particularly regarding mortgage and home equity loans, may change depending on the economic or political climate.***

Real estate comprises the most significant asset for a substantial number of households in Korea, and the movements of the housing price have generally had a significant impact on the direction of domestic economy. Accordingly, regulating housing prices, either in terms of attempting to stem actual or anticipated excessive speculation during times of a suspected housing price bubble and spur the pricing and/or volume of real estate transactions during times of a depressed real estate market by way of tax subsidy, guidelines to lending institutions or otherwise, has been a key policy initiative for the Korean government.

For example, during the early to mid-2000s, the Government adopted several regulatory measures, including in relation to retail banking, to stem a rise in speculation in real estate investments generally and in select areas. Some of the measures undertaken in the past include requiring financial institutions to impose stricter debt-to-income ratio and loan-to-value ratio requirements for mortgage loans for real property located in areas deemed to have engaged in a high level of speculation, raising property tax on real estate transactions for owners of multiple residential units, adopting a ceiling on the sale price of newly constructed housing units and recommending that commercial banks restrain from making further mortgage and home equity lending, among others. More recently, amid a prolonged slump in the housing market in Korea, in April 2013, the Government announced the Real Estate Comprehensive Countermeasure, which provides for, among other things, (i) reduced capital gains tax and (ii) exemption of acquisition tax for first-time homebuyers. In addition, in November 2013, the Government announced a permanent reduction in acquisition tax, with retrospective application from August 2013. Prior to such reduction, acquisition tax was assessed on a differentiated scale based on whether the homebuyer was purchasing a primary home or a secondary home, with the former being assessed an acquisition tax of 2% for the purchase of homes under ₩900 million and 4% for homes exceeding ₩900 million, and the latter being assessed an acquisition tax of 4% regardless of the price of the home. Under the new regulatory structure, the differentiated tax scale for primary homes and secondary homes is eliminated, and all homebuyers are assessed an acquisition tax of 1% for the purchase of homes under ₩600 million, 2% for homes exceeding ₩600 million but less than ₩900 million and 3% for homes exceeding ₩900 million. In addition, in July 2014 the Government imposed a maximum loan-to-value ratio of 70% in the case of housing loans for all financial institutions (compared to different loan-to-value ratios applied previously, depending on the location of the property and the type of the lender) and a maximum debt-to-income ratio of 60% for all financial institutions in respect of residential properties in the greater Seoul metropolitan area. Furthermore, in December 2014 the National Assembly also passed several bills that are designed to stimulate the real estate market.

While any Government measure that is designed to stimulate the real estate sector may result in growth of, and improved profitability for, our retail lending business (particularly with respect to mortgage and home equity

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loans) at least for the short term, such measure could also result in unintended consequences, including potentially excessive speculation resulting in a bubble for the Korean real estate market and a subsequent market crash. Conversely, if the Government were to change the direction of its stimulative measures (for example, in order to preemptively curtail an actual or anticipated bubble in the real estate market), such change in policy may result in a contraction of the real estate market, a decline in real estate prices and consequently, a reduction in the growth of, and profitability for, our retail and/or other lending businesses, as well as otherwise have an adverse effect on our business, financial condition and results of operations or profitability. See Risks Relating to Our Banking Business A decline in the value of the collateral securing our loans or our inability to fully realize the collateral value may adversely affect our credit portfolio.

**Risks Relating to Korea**

*Unfavorable financial and economic conditions in Korea and globally may have a material adverse impact on our asset quality, liquidity and financial performance.*

We are incorporated in Korea, where most of our assets are located and most of our income is generated. As a result, we are subject to political, economic, legal and regulatory risks specific to Korea, and our business, results of operations and financial condition are substantially dependent on developments relating to the Korean economy. As Korea's economy is highly dependent on the health and direction of the global economy, and investor's reactions to developments in one country can have adverse effects on the securities price of companies in other countries, we are also subject to the fluctuations of the global economy and financial markets. Factors that determine economic and business cycles in the Korean or global economy are for the most part beyond our control and inherently uncertain. In addition to discussions of recent developments regarding the global economic and market uncertainties and the risks relating to us as provided elsewhere in this section, factors that could hurt Korea's economy in the future include, among others:

fiscal difficulties political turbulence and increased sovereign default risks in select countries in Europe and the resulting adverse effects on the global financial markets;

adverse change or increased volatility in macroeconomic indicators, including interest rates, inflation level, foreign currency reserve levels, commodity prices (including oil prices), exchange rates (including fluctuation of U.S. Dollar, Euro or Japanese Yen or revaluation of the Renminbi), stock market indices and inflows and outflows of foreign capital;

adverse developments in the economies of countries and regions that are Korea's important export markets (such as the United States, China and Japan) and deterioration in economic or diplomatic relations between Korea and its major trading partners or allies, including as a result of trading or territorial disputes or disagreements in foreign policy;

continued sluggishness in the Korean real estate market;

a continuing rise in the level of household debt and an increase in delinquency and credit default by retail or small- and medium-sized enterprise borrowers;

a rise in unemployment or stagnation of real wages;

an increase in social expenditures to support an aging population or decreases in productivity due to shifting demographics;

social and labor unrest;

a decline in consumer confidence and a slowdown in consumer spending and corporate investments;

a widening fiscal deficit from a decrease in tax revenues and a substantial increase in the Government's expenditures for fiscal stimulus, unemployment compensation and other economic and social programs;

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political gridlock within the government or in the legislature, which prevents or disrupts timely and effective policy making;

laws, regulations or other government actions (financial, economic or otherwise) that fail to achieve desired policy objectives, produce adverse unintended consequences or otherwise constrain or distort sound economic activities;

loss of investor confidence arising from corporate accounting irregularities and corporate governance issues, including in respect of certain *chaebols*; and

any other developments that has a material adverse effect on the global or Korean economy, such as geopolitical tensions (such as in the Crimea peninsula, certain former republics of the Soviet Union, the Middle East and the Korean peninsula), an act of war, a terrorist act, a breakout of an epidemic or natural or man-made disasters (such as the sinking of the Sewol ferry in April 2014, which significantly dampened consumer sentiment in Korea for months).

Any future deterioration of the Korean economy could have an adverse effect on our business, financial condition and results of operations.

***Tensions with North Korea could have an adverse effect on us, the price of our common shares and our American depositary shares.***

Relations between Korea and North Korea have been tense throughout Korea's modern history. The level of tension between the two Koreas has fluctuated and may increase abruptly as a result of current and future events. In particular, there continues to be uncertainty regarding the long-term stability of North Korea's political leadership since the succession of Kim Jong-un to power following the death of his father in December 2011, which has raised concerns with respect to the political and economic future of the region.

In addition, there continues to be heightened security tension in the region stemming from North Korea's hostile military and diplomatic actions, including in respect of its nuclear weapons and long-range missile programs. Some examples from recent years include the following:

In December 2014, North Korea allegedly hacked into Sony's network to prevent the airing of the movie *The Interview* which unfavorably portrays the North Korean leader, which has prompted the United States to consider implementing additional economic sanctions against North Korea.

In March 2013, North Korea stated that it had entered a state of war with Korea, declaring the 1953 armistice invalid, and put its artillery at the highest level of combat readiness to protest the Korea-United States allies military drills and additional sanctions imposed on North Korea for its missile and nuclear tests.

North Korea renounced its obligations under the Nuclear Non-Proliferation Treaty in January 2003 and conducted three rounds of nuclear tests between October 2006 to February 2013, which increased tensions in

the region and elicited strong objections worldwide. In response, the United Nations Security Council unanimously passed resolutions that condemned North Korea for the nuclear tests and expanded sanctions against North Korea, most recently in March 2013.

In December 2012, North Korea launched a satellite into orbit using a long-range rocket, despite concerns in the international community that such a launch would be in violation of the agreement with the United States as well as United Nations Security Council resolutions that prohibit North Korea from conducting launches that use ballistic missile technology.

North Korea's economy also faces severe challenges, including severe inflation and food shortages, which may further aggravate social and political tensions within North Korea. In addition, reunification of Korea and North Korea may suddenly occur in the future, which would entail significant economic commitment and

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expenditure by Korea that may outweigh any resulting economic benefits of reunification. Any further increase in tension or uncertainty relating to the military, political or economic stability in the Korean peninsula, including a breakdown of diplomatic negotiations over the North Korean nuclear program, occurrence of military hostilities, heightened concerns about the stability of North Korea's political leadership or its actual collapse, a leadership crisis, a breakdown of high-level contacts or accelerated reunification could have a material adverse effect on our business, financial condition and results of operations, as well as the price of our common shares and our American depositary shares.

**Risks Relating to Our American Depositary Shares**

*There are restrictions on withdrawal and deposit of common shares under the depositary facility.*

Under the deposit agreement, holders of shares of our common stock may deposit those shares with the depositary bank's custodian in Korea and obtain American depositary shares, and holders of American depositary shares may surrender American depositary shares to the depositary bank and receive shares of our common stock. However, under current Korean laws and regulations, the depositary bank is required to obtain our prior consent for the number of shares to be deposited in any given proposed deposit which exceeds the difference between (1) the aggregate number of shares deposited by us for the issuance of American depositary shares (including deposits in connection with the initial and all subsequent offerings of American depositary shares and stock dividends or other distributions related to these American depositary shares) and (2) the number of shares on deposit with the depositary bank at the time of such proposed deposit. We have consented to the deposit of outstanding shares of common stock as long as the number of American depositary shares outstanding at any time does not exceed 40,432,628. As a result, if you surrender American depositary shares and withdraw shares of common stock, you may not be able to deposit the shares again to obtain American depositary shares.

*Ownership of our shares is restricted under Korean law.*

Under the Financial Holding Companies Act, any single shareholder (together with certain persons in a special relationship with such shareholder) may acquire beneficial ownership of up to 10% of the total issued and outstanding shares with voting rights of a bank holding company controlling national banks such as us. In addition, any person, except for a non-financial business group company (as defined below), may acquire in excess of 10% of the total voting shares issued and outstanding of a financial holding company which controls a national bank, provided that a prior approval from the Financial Services Commission is obtained each time such person's aggregate holdings exceed 10% (or 15% in the case of a financial holding company controlling regional banks only), 25% or 33% of the total voting shares issued and outstanding of such financial holding company. The Government and the Korea Deposit Insurance Corporation are exempt from this limit. Furthermore, certain non-financial business group companies (i.e., (i) any same shareholder group with aggregate net assets of all non-financial business companies belonging to such group of not less than 25% of the aggregate net assets of all members of such group; (ii) any same shareholder group with aggregate assets of all non-financial business companies belonging to such group of not less than ₩2 trillion; or (iii) any mutual fund in which a same shareholder group identified in (i) or (ii) above owns more than 4% of the total shares issued and outstanding of such mutual fund) may not acquire beneficial ownership in us in excess of 4% of our outstanding voting shares, provided that such non-financial business group companies may acquire beneficial ownership of up to 10% of our outstanding voting shares with the approval of the Financial Services Commission under the condition that such non-financial business group companies will not exercise voting rights in respect of such shares in excess of the 4% limit. See Item 4.B. Business Overview Supervision and Regulation Principal Regulations Applicable to Financial Holding Companies Restrictions on Financial Holding Company Ownership. To the extent that the total number of shares of our common stock that you and your affiliates own together exceeds these limits, you will not be entitled to exercise the voting rights for the excess shares, and the Financial Services Commission may

order you to dispose of the excess shares within a period of up to six months. Failure to comply with such an order would result in a fine of up to ₩50 million, plus an additional charge of up to 0.03% of the book value of such shares per day until the date of disposal.



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***Holders of our ADSs will not have preemptive rights in certain circumstances.***

The Korean Commercial Code and our articles of incorporation require us, with some exceptions, to offer shareholders the right to subscribe for new shares in proportion to their existing ownership percentage whenever new shares are issued. If we offer any rights to subscribe for additional shares of our common stock or any rights of any other nature, the depositary bank, after consultation with us, may make the rights available to you or use reasonable efforts to dispose of the rights on your behalf and make the net proceeds available to you. The depositary bank, however, is not required to make available to you any rights to purchase any additional shares unless it deems that doing so is lawful and feasible and:

a registration statement filed by us under the U.S. Securities Act of 1933, as amended, is in effect with respect to those shares; or

the offering and sale of those shares is exempt from or is not subject to the registration requirements of the U.S. Securities Act.

We are under no obligation to file any registration statement with the U.S. Securities and Exchange Commission. If a registration statement is required for you to exercise preemptive rights but is not filed by us, you will not be able to exercise your preemptive rights for additional shares and you will suffer dilution of your equity interest in us.

***Holders of our ADSs will not be able to exercise dissent and appraisal rights unless they have withdrawn the underlying shares of our common stock and become our direct stockholders.***

Under Korean law, in some limited circumstances, including the transfer of the whole or any significant part of our business and the merger or consolidation of us with another company, dissenting stockholders have the right to require us to purchase their shares under Korean law. However, under our deposit agreement, holders of our American depositary shares do not have, and may not instruct the depositary as to the exercise of, any dissenter's rights provided to the holders of our common shares under Korean law. Therefore, if holders of our American depositary shares wish to exercise dissenting rights, they must withdraw the underlying common stock from the American depositary shares facility (and incur charges relating to that withdrawal) and become our direct stockholders prior to the record date of the stockholders' meeting at which the relevant transaction is to be approved, in order to exercise dissent and appraisal rights.

***The market value of your investment in our ADSs may fluctuate due to the volatility of the Korean securities market.***

Our common stock is listed on the KRX KOSPI Division of the Korea Exchange, which has a smaller market capitalization and is more volatile than the securities markets in the United States and many European countries. The market value of ADSs may fluctuate in response to the fluctuation of the trading price of shares of our common stock on the Stock Market Division of the Korea Exchange. The Stock Market Division of the Korea Exchange has experienced substantial fluctuations in the prices and volumes of sales of listed securities and the Stock Market Division of the Korea Exchange has prescribed a fixed range in which share prices are permitted to move on a daily basis. Like other securities markets, including those in developed markets, the Korean securities market has experienced problems including market manipulation, insider trading and settlement failures. The recurrence of these or similar problems could have a material adverse effect on the market price and liquidity of the securities of Korean companies, including our common stock and ADSs, in both the domestic and the international markets.

The Korean government has the potential ability to exert substantial influence over many aspects of the private sector business community, and in the past has exerted that influence from time to time. For example, the Government has promoted mergers to reduce what it considers excess capacity in a particular industry and has also encouraged private companies to publicly offer their securities. Similar actions in the future could have the

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effect of depressing or boosting the Korean securities market, whether or not intended to do so. Accordingly, actions by the government, or the perception that such actions are taking place, may take place or has ceased, may cause sudden movements in the market prices of the securities of Korean companies in the future, which may affect the market price and liquidity of our common stock and ADSs.

***Your dividend payments and the amount you may realize upon a sale of your ADSs will be affected by fluctuations in the exchange rate between the U.S. Dollar and the Won.***

Investors who purchase the American depositary shares will be required to pay for them in U.S. Dollars. Our outstanding shares are listed on the Korea Exchange and are quoted and traded in Won. Cash dividends, if any, in respect of the shares represented by the American depositary shares will be paid to the depositary bank in Won and then converted by the depositary bank into U.S. Dollars, subject to certain conditions. Accordingly, fluctuations in the exchange rate between the Won and the U.S. Dollar will affect, among other things, the amounts a registered holder or beneficial owner of the American depositary shares will receive from the depositary bank in respect of dividends, the U.S. Dollar value of the proceeds which a holder or owner would receive upon sale in Korea of the shares obtained upon surrender of American depositary shares and the secondary market price of the American depositary shares.

***If the Government deems that certain emergency circumstances are likely to occur, it may restrict the depositary bank from converting and remitting dividends in Dollars.***

If the Government deems that certain emergency circumstances are likely to occur, it may impose restrictions such as requiring foreign investors to obtain prior Government approval for the acquisition of Korean securities or for the repatriation of interest or dividends arising from Korean securities or sales proceeds from disposition of such securities. These emergency circumstances include any or all of the following:

sudden fluctuations in interest rates or exchange rates;

extreme difficulty in stabilizing the balance of payments; and

a substantial disturbance in the Korean financial and capital markets.

The depositary bank may not be able to secure such prior approval from the government for the payment of dividends to foreign investors when the Government deems that there are emergency circumstances in the Korean financial markets.

## **Other Risks**

***We are generally subject to Korean corporate governance and disclosure standards, which differ in significant respects from those in other countries.***

Companies in Korea, including us, are subject to corporate governance standards applicable to Korean public companies which differ in many respects from standards applicable in other countries, including the United States. As a reporting company registered with the Securities and Exchange Commission and listed on the New York Stock Exchange, we are, and in the future will be, subject to certain corporate governance standards as mandated by the Sarbanes-Oxley Act of 2002. However, foreign private issuers, including us, are exempt from certain corporate

governance requirements under the Sarbanes-Oxley Act or under the rules of the New York Stock Exchange. For significant differences, see Item 16.G. Corporate Governance. There may also be less publicly available information about Korean companies, such as us, than is regularly made available by public or non-public companies in other countries. Such differences in corporate governance standards and less public information could result in less than satisfactory corporate governance practices or disclosure to investors in certain countries.

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**Table of Contents*****You may not be able to enforce a judgment of a foreign court against us.***

We are a corporation with limited liability organized under the laws of Korea. Substantially all of our directors and officers and other persons named in this annual report reside in Korea, and all or a significant portion of the assets of our directors and officers and other persons named in this annual report and substantially all of our assets are located in Korea. As a result, it may not be possible for holders of the American depository shares to affect service of process within the United States, or to enforce against them or us in the United States judgments obtained in United States courts based on the civil liability provisions of the federal securities laws of the United States. There is doubt as to the enforceability in Korea, either in original actions or in actions for enforcement of judgments of United States courts, of civil liabilities predicated on the United States federal securities laws.

***We may become a passive foreign investment company ( PFIC ), which could result in adverse U.S. tax consequences to U.S. investors.***

Based upon the past and projected composition of our income and valuation of our assets, we do not believe that we were a PFIC for 2014, and we do not expect to be a PFIC in 2015 or to become one in the foreseeable future, although there can be no assurance in this regard. If, however, we become a PFIC, such characterization could result in adverse U.S. tax consequences to you if you are a U.S. investor. For example, if we become a PFIC, our U.S. investors will become subject to increased tax liabilities under U.S. tax laws and regulations and will become subject to burdensome reporting requirements. Our PFIC status is determined on an annual basis and depends on the composition of our income and assets. Specifically, we will be classified as a PFIC for U.S. tax purposes if either: (i) 75% or more of our gross income in a taxable year is passive income, or (ii) the average percentage of our assets by value in a taxable year which produce or are held for the production of passive income (which generally includes cash) is at least 50%. Special rules treat certain income earned by a non-U.S. corporation engaged in the active conduct of a banking business as non-passive income. See Item 10.E. Taxation Certain United States Federal Income Tax Consequences Passive Foreign Investment Company Rules. We cannot assure you that we will not be a PFIC for 2015 or any future taxable year.

**ITEM 4. INFORMATION ON THE COMPANY****ITEM 4.A. History and Development of the Company****Introduction**

We are one of the leading financial institutions in Korea in terms of total assets, revenues, profitability and capital adequacy, among others. Incorporated on September 1, 2001, we are the first privately-held financial holding company to be established in Korea. Since inception, we have developed and introduced a wide range of financial products and services in Korea and aimed to deliver comprehensive financial solutions to clients through a convenient one-portal network. According to reports by the Financial Supervisory Service, we are the largest financial services provider in Korea as measured by total assets as of December 31, 2014 and operate the third largest banking business (as measured by consolidated total assets as of December 31, 2014) and the largest credit card business (as measured by the total credit purchase volume as of December 31, 2014) in Korea.

We have experienced substantial growth through several mergers and acquisitions. Most notably, our acquisition of Chohung Bank in 2003 has enabled us to have the third largest banking operations in Korea. In addition, our acquisition in March 2007 of LG Card, the then largest credit card company in Korea, has enabled to have the largest

credit card operations in Korea and significantly expand our non-banking business capacity so as to achieve a balanced business portfolio.

We currently have 13 direct subsidiaries and 18 indirect subsidiaries offering a wide range of financial products and services, including commercial banking, corporate banking, private banking, credit card, asset

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management, brokerage and insurance services. We believe that such breadth of services will help us to meet the diversified needs of our present and potential clients. We currently serve approximately 29 million active customers, which we believe is the largest customer base in Korea, through approximately 23,555 employees at approximately 1,372 network branches group-wide. While substantially all of our revenues have been historically derived from Korea, we aim to serve the needs of our customers through a global network of 76 offices in the United States, Canada, the United Kingdom, Japan, the People's Republic of China, Germany, India, Hong Kong, Vietnam, Cambodia, Kazakhstan, Singapore, Mexico, Uzbekistan, Myanmar and Poland.

Our registered office and corporate headquarters are located at 20, Sejong-daero 9-gil, Jung-gu, Seoul 100-724, Korea and our telephone number is +822 6360 3000.

## **Our Strategy**

Since our inception in 2001, we have pursued the following objectives as the core of our long-term strategy: (i) balanced growth in our banking and non-banking businesses, (ii) continued creation of value by identifying new business opportunities and gaining a competitive edge through differentiating our business model from that of our competitors, and (iii) becoming the market leader in Korea and a world-class financial holding company through enhancement of our management systems and core competencies.

Following the global financial crisis that began in the second half of 2008, a new set of challenges for financial service providers such as us and our subsidiaries has emerged in the form of a new normal in the business environment with the following general features: (i) stricter financial regulations and regulatory scrutiny with a focus on heightened risk management, (ii) less tolerance for unbalanced risk in financial products, (iii) demand for higher levels of capital adequacy and reduced debt levels, (iv) greater market acceptability of a business model that emphasizes stable and conservative growth even at the expense of higher return, and (v) rising political and social skepticism of unfettered capitalism and stronger demand for enhanced social responsibility and accountability of financial institutions. In addition, advances in mobile and other technologies are renewing challenges for financial service providers to continually reexamine their existing business models. Combined, these developments require that we continue to seek opportunities to foster customer trust, enhance our social capital and quickly adapt ourselves to the constant changes in our business environment.

Accordingly, in recognition of these trends in our business environment, we have strived to, and will continue to strive to, re-make ourselves with an overarching focus of putting our customers first, namely by constantly seeking ways to make our interactions with customers more user-friendly and customer-oriented, as well as further strengthening risk management, efficiently using our resources and selectively identifying new growth opportunities.

Our mid- to long-term strategic target is to become Korea's number one financial brand by the end of 2015 through emphasis on creation of value to our customers and fostering good growth. We believe that establishing ourselves firmly as the market leader in Korea is critical to realizing our ultimate objective of becoming a world-class financial institution, and our strategic priorities reflect our continual commitment to sustainable growth, stable profitability and best-class core competencies.

Recently, we have also added to our groupwide mission the concept of Compassionate Finance, Your Companion for the Future. This notion leverages on our strategic theme that we can make a better world through the power of finance. To elaborate, by the power of finance, we mean that we can enable our customers to achieve their desired financial objectives through differentiated financial products and services (including asset management) using innovative techniques and planning that reflect or anticipate the changes in customer preferences and market and regulatory environments. In addition, by making a better world, we mean that we as a financial service provider aim to add value

to the customer, which in turn will create a virtuous cycle whereby our franchise value also increases in tandem with the added value to the customer, which will over the



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long term benefit the society we live in on a global basis. Thus, we believe compassionate finance , innovating financing and a virtuous cycle of mutual benefit are all interconnected themes that form the overarching backbone to our overall strategy.

More specifically, our key strategic priorities currently include the following:

*Solidify our market position as the local best in our core businesses.* Currently, our two core businesses of banking and credit cards rank as number one in their respective industries (banking in terms of profitability and credit cards in terms of market share and the number of customers). We seek to solidify our brand and market position in these fields as the indisputable local best in both quantitative and qualitative terms by offering our customers quality service that clearly differentiates us from our competitors. To this end, in our banking business, we will seek to offer a variety of products and services tailored to each customer segment, enhance service capabilities that do not require customers' physical presence in our branch offices and increase its distribution network outside the Seoul metropolitan area. As for our credit card business, we seek to further solidify our market leadership position and generate further revenue growth by offering new differentiated services and exploring opportunities in the emerging arena of strategic convergence between financial services providers and telecommunication service providers as well as other potential business opportunities on a selective basis, as well as further improve our cost structure. In addition, we seek to establish firm industry leadership for our leasing business through differentiated services in order to further contribute to our goal of sustainable growth.

*Strengthen fee-earnings businesses.* While we will continue to focus on our core, interest income generating business of banking and credit card services, in order to attain a more balanced overall business portfolio as well as in anticipation of a potential rise in interest rates and cost of capital, we plan to strengthen our businesses that generate non-interest fee income, such as asset management, insurance and securities. To this end, we are currently re-evaluating the business models for our key business segments with the goal of strengthening our competitiveness in areas of core competencies that will ensure our long-term viability and profitability. More specifically, our asset management business will focus on building the Shinhan brand through continued customer-oriented product development, our securities business will support our asset management business through developing and distributing new investment products and enhancing marketing channels, and our insurance business will seek to join the top tier in the industry through organic growth and selectively leveraging other business opportunities.

*Enhance synergy through shared focus on the customer.* We plan to renew our commitment to our founding principle of emphasizing customer-oriented service by streamlining our business lines to provide a comprehensive financial services package tailored to each customer's lifestyle and financial needs, as well as enhancing customer access to our diverse product offerings through a more customer-friendly one portal financial service platform. To that end, we are identifying precedents that can serve as useful guidelines for successful intra-group synergy generation and are building clear and comprehensive joint marketing models that can provide specific guidance for differentiated synergy output for our entire group.

*Gain competitiveness in strategic growth areas.* In light of the increasing maturation of the domestic financial services sector, we intend to seek new business opportunities at the group level by sharing

group-wide management resources to identify and develop potential strategic growth areas. In particular, we plan to enhance the competitiveness of our investment banking business so as to be on par with our group-wide market leadership by redefining its business model and selectively entering into international markets, with an initial focus on Asia. In addition, we will explore selectively entering into strategic alliances with telecommunications service providers and retail grocery and department store chains to take advantage of new business opportunities generated by technological developments and the growing prominence of retail chains in the distribution of financial services.

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In order to effectively achieve the foregoing strategic objectives, we plan to continue to enhance our business fundamentals in the following areas:

systematic build-up of future-oriented compassionate finance through (i) group-wide adoption and implementation of various operating systems and infrastructure designed to enhance customer value in our marketing and other business generation efforts, (ii) continued development of products and services specifically tailored to promote the theme of compassionate finance, (iii) strengthening support for low-income households and small businesses, and (iv) embedding compassionate finance into the group-wide culture through continuous internal education and outside consulting, including through promotional campaigns for successful cases of compassionate finance;

expanded offering of differentiated financial services, particularly in the area of retirement and other financial planning, in light of the fast-aging demographics in Korea on the basis of our existing extensive service platform and the trust we have built up with our customers;

strengthening a results-oriented approach for our international expansion efforts, including through a joint introduction of our banking and non-banking services in select regions, localization of product offering and operational processes and enhancing our local marketing competencies;

upgrading our distribution channels in order to take a leading role in setting the future direction of the financial services industry, such as by preemptively developing new channels in anticipation of changes arising from new information technology capabilities, ramping up customer access to our services without having to visit our branches in person and integration of our various service offerings in our branches;

systemized strategic cost-savings through (i) implementation of a group-wide efficiency management optimization system, (ii) continuous organizational slimming, and (iii) realignment of the group-wide business portfolio. The efficiency optimization system will focus on optimizing internal and external operational networks for productivity improvement, streamlining operational processes for low-cost efficiency, rationalizing human resources, and selective reinforcement of core competencies such as information technology systems and top-performing employees. Organizational slimming will include restructuring of low-profitability business units, outsourcing of non-core business areas and simplifying decision-making processes. Realignment of the group-wide business portfolio will involve re-evaluation of the existing business models for our core business units, selective entry into new business areas through joint ventures or strategic alliances and formulation of more profitable and balanced business portfolios;

increased investment in employee training and professional development, with a focus on nurturing leaders for the next generation; and

balanced risk-return management.

At the subsidiary level, we plan to implement the following strategies with respect to our core business lines:

*in commercial banking*, our primary objective is to strengthen our competitive position and become the leading bank in Korea by enhancing customer satisfaction, locking in the loyalty of our existing banking customers and further enlarging our customer base. To this end, we plan to fully leverage the scale of our banking operation afforded by our extensive branch network, emphasize cross-selling non-banking products at our banking network, offer total financial service packages, bolster our brand image and further upgrade our customer service infrastructure, risk management systems and other operating processes. We also intend to enter, on a selective basis, into promising new businesses by strengthening our investment banking, private banking and other fee-based businesses, making significant inroads into the retirement pension market, and offering differentiated wealth management strategies and portfolios.

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*in credit card business*, our primary objective is to further solidify our market leadership as the largest credit card service provider in Korea through differentiated and tailored customer service based on a strategy that emphasizes soft and smart aspects of enhancing customer loyalty, brand recognition and revenue expansion. We will also emphasize further optimizing our risk management through preemptive risk prevention, creating new synergy opportunities through collaboration with our other Shinhan affiliates and enhanced use of the group-wide customer relationship management system. As a way of identifying and exploring new potential growth areas, we are also exploring various business opportunities associated with technological advancements in providing financial services (commonly referred to as *fin-tech*) and also, on a selective basis, entering into strategic alliances with telecommunications service providers and market-leading department and discount store chains for further expansion of our distribution network.

*in securities business*, our primary objective is to establish a solid platform for providing leading brokerage and financial advisory services in Korea in light of the recent deregulations of the securities industries in Korea. We aim to selectively develop competitive business models and capture promising business opportunities, including wealth management and investment advisory services. Our near-term strategic objective is to promote cross-selling, and in order to achieve this end, we have implemented strategies to enhance our research and preemptive risk management capabilities and maximize our group-wide synergy base.

*in life insurance business*, our primary objective is to enhance our market position as one of the leading insurers in Korea. To that end, we aim to maximize the use of our group-wide distribution channels, particularly in banking and credit card businesses, in order to foster direct interaction with customers. We also aim to train specialists and offer differentiated products targeting the fast-growing senior citizen population in Korea.

## **Our History and Development**

On September 1, 2001, we were formed as a financial holding company under the Financial Holding Companies Act, as a result of acquiring all of the issued shares of the following four entities from their former shareholders in exchange for shares of our common stock: (i) Shinhan Bank, a nationwide commercial bank listed on the Korea Exchange, (ii) Shinhan Securities Co., Ltd., a securities brokerage company listed on the Korea Exchange, (iii) Shinhan Capital Co., Ltd., a leasing company listed on the Korea Exchange Korean Securities Dealers Automated Quotations ( *KRX KOSDAQ* ), and (iv) Shinhan Investment Trust Management Co., Ltd., a privately held investment trust management company. On September 10, 2001, the common stock of our holding company was listed on what is currently the *KRX KOSPI* Market.

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Since our inception, we have expanded our operations, in large part, through strategic acquisitions or formation of joint ventures. Our key acquisitions and joint venture formations are described as below:

<b>Date of Acquisition</b>	<b>Entity</b>	<b>Principal Activities</b>	<b>Method of Establishment</b>
April 2002	Jeju Bank	Regional banking	Acquisition from Korea Deposit Insurance Corporation
July 2002	Shinhan Investment Corp. <sup>(1)</sup>	Securities and investment	Acquisition from the SsangYong Group
August 2002	Shinhan BNP Paribas Investment Trust Management Co., Ltd. <sup>(2)</sup>	Investment advisory	50:50 joint venture with BNP Paribas
August 2003	Chohung Bank	Commercial banking	Acquisition from creditors
December 2005	Shinhan Life Insurance	Life insurance services	Acquisition from shareholders
March 2007	LG Card	Credit card services	Acquisition from creditors
January 2012	Tomato Mutual Savings Bank <sup>(3)</sup>	Savings bank	Purchase and assumption of assets and liabilities from creditors
January 2013	Yehanbyoul Savings Bank <sup>(4)</sup>	Savings bank	Acquisition from Korea Deposit Insurance Corporation

*Notes:*

(1) Renamed as Shinhan Investment Corp. from Goodmorning Shinhan Securities Co., Ltd. effective August 2009.

(2) In January 2009, SH Asset Management Co., Ltd. and Shinhan BNP Paribas Investment

Trust Management merged to form Shinhan BNP Paribas Asset Management Co., Ltd.

- (3) Shinhan Hope Co., Ltd. was established on December 12, 2011, to purchase and assume certain assets and liabilities of Tomato Mutual Savings Bank. On December 28, 2011, Shinhan Hope Co., Ltd. obtained a savings bank license, changed its name to Shinhan Savings Bank and became our direct subsidiary.
- (4) In January 2013, we entered into a share purchase agreement with Korea Deposit Insurance Corporation for the acquisition of Yehanbyoul Savings Bank, a savings bank located in Korea, for ₩45.3 billion, and received regulatory approval to merge Yehanbyoul Savings Bank into our existing subsidiary Shinhan Saving Bank. On April 1, 2013, Shinhan Savings Bank and Yehanbyoul Savings Bank merged into a single entity, with Yehanbyoul Savings Bank being the surviving entity and the newly merged bank being named Shinhan Savings Bank.

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**ITEM 4.B. Business Overview**

*Unless otherwise specifically mentioned, the following business overview is presented on a consolidated basis under IFRS.*

**Our Principal Activities**

We provide comprehensive financial services, principally consisting of the following:

commercial banking services, consisting of:

retail banking, which primarily focuses on making loans to or receiving deposits from individual customers (including high net-worth individuals and families) and, to a lesser extent, not-for-profit institutions such as hospitals, airports and schools;

corporate and investment banking services, which primarily focuses on making loans to or receiving deposits from for-profit corporations, including small- and medium-sized enterprises;

international banking, which primarily focuses on management of overseas subsidiaries and branch operations and other international businesses, as well as internal asset and liability management, trading of securities and derivatives, investment portfolio management and other related activities; and

other banking, which primarily focuses on administration of banking operations.

credit card services;

securities brokerage services;

life insurance services;

asset management services, including brokerage and trading of various securities, related margin lending and deposit and trust services, and other asset management services; and

other services, including leasing and equipment financing, regional banking services, savings banking services, loan collection and credit reporting, collective investment administrative services and financial system development services as well as engaging in private equity investments through formation of private equity funds on a private placement basis.



In addition to the above-mentioned business activities, we, at the holding company level, have the wealth management planning team and corporate and investment banking planning team, whose primary function is to support cross-divisional management with respect to these specific functional areas.

Our principal business activities are not subject to any material seasonal trends. While we have a number of overseas branches and subsidiaries, substantially all of our assets are located, and substantially all of our revenues are generated, in Korea.

### ***Deposit-Taking Activities***

Principally through Shinhan Bank, we offer many deposit products that target different customer segments with features tailored to each segment's financial and other profile. Our deposit products consist principally of the following:

*Demand deposits.* Demand deposits do not accrue interest or accrue interest at a lower rate than time or savings deposits and allow the customer to deposit and withdraw funds at any time. If interest-bearing, demand deposits have interest accruing at a fixed or variable rate depending on the period and the amount of deposit. Demand deposits constituted approximately 12.3%, 13.7% and 13.6% of our total deposits as of December 31, 2012, 2013 and 2014, respectively. Our demand deposits paid average interest of 0.68%, 0.65% and 0.57% in 2012, 2013 and 2014, respectively.

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*Savings deposits.* Savings deposits allow the customer to deposit and withdraw funds at any time and accrue interest at an adjustable interest rate, which is typically lower than the rate applicable to time or installment deposits. Savings deposits constituted approximately 22.0%, 23.5% and 26.5% of our total deposits as of December 31, 2012, 2013 and 2014, respectively, and paid average interest of 1.24%, 0.96% and 0.87% in 2012, 2013 and 2014, respectively.

*Time deposits.* Time deposits generally require the customer to maintain a deposit for a fixed term during which the deposit accrues interest at a fixed rate or a variable rate based on certain financial indexes, including the Cost of Funds Index ( COFIX ). If the deposit is withdrawn prior to the end of the fixed term, the customer is paid a lower interest rate than that originally offered. The term typically ranges from one month to five years. Time deposits constituted approximately 64.9%, 61.8% and 58.8% of our total deposits as of December 31, 2012, 2013 and 2014, respectively, and paid average interest of 3.63%, 3.00% and 2.58% in 2012, 2013 and 2014, respectively.

*Other deposits.* Other deposits consist mainly of certificates of deposit. Certificates of deposit typically have maturities from 30 days to two years. Interest rates on certificates of deposit are determined based on the length of the deposit and prevailing market interest rates. Certificates of deposit are sold at a discount to their face value, reflecting interest payable on the certificates of deposit. Certificates of deposit constituted approximately 0.8%, 1.0% and 1.1% of our total deposits as of December 31, 2012, 2013 and 2014, respectively. Our certificates of deposit paid average interest of 3.26%, 2.01% and 1.32% in 2012, 2013 and 2014, respectively.

We also offer deposits which provide the customer with preferential rights to housing subscriptions under the Housing Law, and eligibility for mortgage and home equity loans. These products include:

*Housing subscription time deposits.* These deposit products are special purpose time deposits providing the customer with a preferential right to subscribe for new private housing units under the Housing Law and Rules on Housing Supply (the Housing Law ). This law provides various measures supporting the purchase of housing units and the supply of such housing units by construction companies. If a potential home-buyer subscribes for these deposit products and holds them for a certain period of time set forth in the Housing Law, such deposit customer obtains the right to subscribe for new private housing units on a priority basis. Such preferential rights are neither transferable nor marketable in the open market. These products accrue interest at a fixed rate for one year and at an adjustable rate after one year, which are consistent with other time deposits. Required deposit amounts per account range from ₩2 million to ₩15 million depending on the size and location of the housing unit. These deposit products target high- and middle-income households as customers.

*Housing subscription installment savings deposits.* These deposit products are monthly installment savings products providing the customer with a preferential right to subscribe for new private housing units under the Housing Law. Such preferential rights are neither transferable nor marketable in the open market. These deposits require monthly installments of ₩50,000 to ₩500,000, have maturities between three and five years and accrue interest at fixed rates depending on the term, which rates are consistent with other installment savings deposits. These deposit products target low- and middle-income households as customers. For information on our deposits in Korean Won based on the principal types of deposit products

we offer, see Description of Assets and Liabilities Funding Deposits.

The rate of interest payable on our deposit products may vary significantly, depending on average funding costs, the rate of return on our interest-earning assets, prevailing market interest rates among financial institutions and other major financial indicators.

We also offer court deposit services for litigants in Korean courts, which involve providing effectively an escrow service for litigants involved in certain types of legal or other proceedings. Chohung Bank historically was a dominant provider of such services since 1958, and following the acquisition of Chohung Bank, we

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continue to hold a dominant market share in these services. Such deposits typically carry interest rates lower than the market rates (by approximately 0.5% per annum) and amounted to ₩6,150 billion, ₩6,680 billion and ₩6,443 billion as of December 31, 2012, 2013 and 2014, respectively.

The Monetary Policy Committee of the Bank of Korea imposes a reserve requirement on Won currency deposits at commercial banks at rates ranging from 0% to 7%, based generally on maturity and the type of deposit instrument. See *Supervision and Regulation* *Principal Regulations Applicable to Banks* *Liquidity*.

The Depositor Protection Act provides for a deposit insurance system under which the Korea Deposit Insurance Corporation guarantees repayment of eligible bank deposits to depositors up to a total of ₩50 million per depositor per bank. See *Supervision and Regulation* *Principal Regulations Applicable to Banks* *Deposit Insurance System*.

***Retail Banking Services******Overview***

We provide retail banking services primarily through Shinhan Bank, and, to a significantly lesser extent, through Jeju Bank, a regional commercial bank. The retail loans, excluding credit card receivables, amounted to ₩84,930 billion as of December 31, 2014.

Retail banking services include mortgage and home equity lending and retail lending as well as demand, savings and fixed deposit-taking, checking account services, electronic banking and ATM services, bill paying services, payroll and check-cashing services, currency exchange and wire fund transfer. We believe that providing modern and efficient retail banking services is important to maintaining our public profile and as a source of fee-based income.

Retail banking has been and will continue to remain one of our core businesses. Our strategy in retail banking is to provide prompt and comprehensive services to retail customers through increased automation and improved customer service, as well as a streamlined branch network focused on sales. The retail segment places an emphasis on targeting high net worth individuals.

***Retail Lending Activities***

We offer various retail loan products, consisting principally of loans to individuals and households. Our retail loan products target different segments of the population with features tailored to each segment's financial profile and other characteristics, including customer's occupation, age, loan purpose, collateral requirements and the duration of the customer's relationship with Shinhan Bank. Our retail loans consist principally of the following:

*Mortgage and home equity loans*, which are mostly comprised of mortgage loans that are used to finance home purchases and are generally secured by the housing unit being purchased; and

*Other retail loans*, which are loans made to customers for any purpose other than mortgage and home equity loans and the terms of which vary based primarily upon the characteristics of the borrower and which are either unsecured or secured, or guaranteed by deposits or by a third party.

As of December 31, 2014, our mortgage and home equity loans and other retail loans accounted for 59.64% and 40.36%, respectively, of our retail loans (excluding credit card loans).

For secured loans, including mortgage and home equity loans, our policy is to lend up to 40% to 70% of the appraisal value of the collateral, after taking into account the value of any lien or other security interest that has priority over our security interest (other than petty claims). The loan-to-value ratio of secured loans is updated on

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a monthly basis using the most recent appraisal value of the collateral. As of December 31, 2014, the loan-to-value ratio of mortgage and home equity loans of Shinhan Bank was approximately 52%. As of December 31, 2014, substantially all of our mortgage and home equity loans were secured by residential property.

Under the Regulation on the Supervision of the Banking Business as amended effective August 1, 2014, our banking subsidiaries (i) are subject to a limit on loan-to-value ratio of 70% when extending home mortgage loans; (ii) are required to comply with a limit on debt-to-income ratio of 60% in extending home mortgage loans (amounting to ₩100 million or more) for the purchase of new apartments that are secured by such apartments appraised at a market value of more than ₩600 million if they are located in areas designated as speculative or (if in the greater Seoul metropolitan area) excessively speculative ; (iii) are required to apply greater flexibility in determining the debt-to-income ratio by considering the expected earnings potential; (iv) are prohibited from accepting apartments located in areas of intense speculation as collateral from borrowers who have already obtained home mortgage loans; (v) in the case of borrowers with two or more loans secured by apartments in areas of intense speculation, are required to limit the extension of the maturity of such loans so that the number of loans secured by apartments in areas of intense speculation held by such borrowers is reduced to one such loan; (v) are prohibited from extending home equity loans to minors; and (vi) are prohibited from accepting apartments located in areas of intense speculation as collateral for company loans with the purpose of acquiring such apartments, except for unavoidable cases.

In addition, the supervising authorities in Korea from time to time issue administrative instructions to Korean banks, which have the effect of regulating the access of borrowers to housing loans and, as such, demand for real estate properties. For example, the Financial Supervisory Service issued administrative instructions to financial institutions to (except in limited circumstances) verify the borrower's ability to repay based on proof of income prior to making a mortgage and home equity loan regardless of the type or value of the collateral or the location of the property, which has had the effect of practically barring the grant of any new mortgage and home equity loans to borrowers without verifiable income.

Our banking subsidiaries extend mortgage and home equity loans in compliance with the applicable regulations and administrative instructions by the relevant supervising authorities.

The following table sets forth a breakdown of our retail loans.

	<b>As of December 31,</b>		
	<b>2012</b>	<b>2013</b>	<b>2014</b>
	<b>(In billions of Won, except percentages)</b>		
<b>Retail loans<sup>(1)</sup></b>			
Mortgage and home-equity loans	₩46,130	₩46,908	₩50,652
Other retail loans <sup>(2)</sup>	28,407	30,242	34,278
Percentage of retail loans to total gross loans	36.73%	37.09%	37.94%

*Notes:*

(1) Before allowance for loan losses and excludes credit card receivables.

(2)

In Korea, construction companies typically require buyers of new homes (including apartment units) to make installment payments of the purchase price well in advance of the title transfer. Commercial banks, including Shinhan Bank, provide advance loans on an unsecured basis to retail borrowers the use proceeds for which is restricted to financing of home purchases. A significant portion of these loans are guaranteed by third parties, which may include the construction company receiving the installment payments, until construction of the home is completed. Once construction is completed and the titles to the homes are transferred to the borrowers, which may take several years, these loans become secured by the new homes purchased by these borrowers. In recognition of the unsecured nature of such loans, we classify such loans as other retail loans.

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The total mortgage and home equity loans amounted to ₩50,652 billion outstanding as of December 31, 2014, and as of such date, consisted of amortizing loans (whose principal is repaid by part of the installment payments thereon) in the amount of ₩40,351 billion and non-amortizing loans in the amount of ₩10,301 billion. In addition, as of December 31, 2014, we also provided lines of credit in the aggregate outstanding amount of ₩515 billion for non-amortizing loans.

*Pricing*

The interest rates payable on Shinhan Bank's retail loans are either periodically adjusted floating rates (based on a base rate determined for three-month, six-month or twelve-month periods derived using an internal transfer price system, which reflects the market cost of funding, as adjusted to account for expenses related to lending and the profit margin of the relevant loan products) or fixed rates that reflect the market cost of funding, as adjusted to account for expenses related to lending and the profit margin. Fixed rate loans have maturities of up to 15 years and are offered only on a limited basis and at a premium to floating rate loans. For unsecured loans, which Shinhan Bank provides on a floating or fixed rate basis, interest rates thereon reflect a margin based on, among other things, the borrower's credit score as determined during its loan approval process. For secured loans, the credit limit is based on the type of collateral, priority with respect to the collateral and the loan-to-value ratio. Shinhan Bank may adjust the pricing of these loans to reflect the borrower's current and/or expected future contribution to Shinhan Bank's profitability. The interest rate on Shinhan Bank's loan products may become adjusted at the time the loan is extended. If a loan is terminated within three years following the date of the loan, the borrower is required to pay an early termination fee, which is calculated generally as 1.5% of the outstanding principal amount of and accrued and unpaid interest on the loan, multiplied by a fraction the numerator of which is the number of the remaining days on the loan until maturity and the denominator of which is the number of days comprising the term of the loan or three years, whichever is greater.

As of December 31, 2014, Shinhan Bank's three-month, six-month and twelve-month base rates were approximately 2.13%, 2.17% and 2.18%, respectively. As of December 31, 2014, Shinhan Bank's fixed rates for mortgage and home equity loans with a maturity of three years, five years and seven years were approximately 3.80%, 3.85% and 4.50%, respectively, and Shinhan Bank's fixed rates for other retail loans with a maturity of one year ranged from 4.74% to 14.00%, depending on the credit scores of its customers.

As of December 31, 2014, 73.11% of Shinhan Bank's total retail loans were floating rate loans and 26.89% were fixed rate loans. As of the same date, 65.45% of Shinhan Bank's retail loans with maturity of more than one year were floating rate loans and 34.55% were fixed rate loans.

The interest rate charged to customers by our banking subsidiaries is based, in part, on the cost of funding index, or COFIX, which is published by the Korean Federation of Banks. COFIX is computed based on the weighted average interest of select funding products (including time deposits, housing and other installment savings deposits, repos, discounted bills and senior non-convertible financial debentures) of nine major Korean banks (comprised of Kookmin Bank, Shinhan Bank, Woori Bank, Hana Bank, Korea Exchange Bank, Nonghyup Bank, Industrial Bank of Korea, Citibank Korea and Standard Chartered Bank Korea). Each bank then independently determines the interest rate applicable to its respective customers by adding a spread to the COFIX based on the difference between the COFIX and such bank's general funding costs, administration fees, the customer's credit score, the maturity of the loan and other customer-specific premiums and discounts based on the customer relationship with such bank. These interest rates are typically adjusted on a monthly basis.

*Private Banking*



We have long focused on customers with high net worth. Our retail banking services include providing private banking services to high net worth customers who seek personal advice in complex financial matters. Our aim in private banking is to help enhance wealth accumulation by, and increase the financial sophistication of, our high net-worth clients by offering them portfolio and fund management, tax consulting and real estate management services, among others.

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As of December 31, 2014, Shinhan Bank operated 25 private banking centers nationwide, including 18 in Seoul, three in the suburbs of Seoul and four in cities located in other regions in Korea. As of December 31, 2014, Shinhan Bank had approximately 6,055 private banking customers, who are typically required to have ₩500 million in deposits with us to qualify for private banking services.

**Corporate and Investment Banking Services***Overview*

We provide corporate banking services, primarily through Shinhan Bank, to small- and medium-sized enterprises, including enterprises known as SOHO (standing for small office, home office), which are small enterprises operated by individuals or households, and, to a lesser extent, to large corporations, including corporations that are affiliated with *chaebols*. We also lend to government-controlled enterprises.

The following table sets forth the balances and percentage of our total lending attributable to each category of our corporate lending business as of the dates indicated.

	2012		As of December 31, 2013		2014	
	(In billions of Won, except percentages)					
Small- and medium-sized enterprises loans <sup>(1)</sup>	₩ 51,324	25.29%	₩ 55,062	26.47%	₩ 59,889	26.75%
Large corporate loans	33,713	16.61	31,412	15.10	33,381	14.91
Others	25,488	12.56	26,698	12.84	27,538	12.30
Total corporate loans	₩ 110,525	54.47%	₩ 113,172	54.41%	₩ 120,808	53.96%

*Note:*

(1) Represents the principal amount of loans extended to corporations meeting the definition of small- and medium-sized enterprises under the Basic Act on Small- and Medium-sized Enterprises and its Presidential Decree.

Shinhan Bank also engages in treasury and securities investment business, which involves, among other things, treasury activities (consisting primarily of internal asset and liability management), securities investment trading and derivatives trading.

*Small- and Medium-sized Enterprises Banking*

Under the Basic Act on Small- and Medium-sized Enterprises (the SME Basic Act) and the related Presidential Decree, as amended effective from February 3, 2015, in order to qualify as a small- and medium-sized enterprise, (i) the enterprise's total assets at the end of the immediately preceding fiscal year must be less than ₩500 billion, (ii) the enterprise must meet the standards prescribed by the Presidential Decree in relation to the average and total

annual sales revenues applicable to the type of its main business, and (iii) the enterprise must meet the standards of management independence from ownership as prescribed by the Presidential Decree, including non-membership in a conglomerate as defined in the Monopoly Regulations and Fair Trade Act. However, if any entity which was a small- and medium-sized enterprise as defined in the SME Basic Act prior to the latest amendment no longer meets such definition following such amendment, such entity will be deemed a small- and medium-sized enterprise for purposes of the SME Basic Act until March 31, 2018. Non-profit enterprises with a number of regular employees not exceeding 300 or revenue of less than ₩30 billion that satisfy certain requirements prescribed in the Basic Act on Small- and Medium-sized Enterprises and its Presidential Decree may qualify as a small- and medium-sized enterprise. Furthermore, cooperatives and federations of cooperatives as prescribed by the Presidential Decree are deemed as small- and medium-sized enterprises, effective from April 15, 2014. As of December 31, 2014, we made loans to 220,135 small- and medium-sized enterprises for an aggregate amount ₩59,889 billion.

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We believe that Shinhan Bank, whose traditional focus has been on small- and medium-sized enterprises lending, is well-positioned to succeed in the small- and medium-sized enterprises market in light of its marketing capabilities (which we believe have provided Shinhan Bank with significant customer loyalty) and its prudent risk management practices, including conservative credit rating systems for credit approval. To maintain or increase its market share of small- and medium-sized enterprises lending, Shinhan Bank:

*has accumulated a market-leading expertise and familiarity as to customers and products.* We believe Shinhan Bank has an in-depth understanding of the credit risks embedded in this market segment and to develop loan and other products specifically tailored to the needs of this market segment;

*operates a relationship management system to provide customer service that is tailored to small-and medium-sized enterprises.* Shinhan Bank currently has relationship management teams in 190 banking branches, of which two are corporate banking branches and 188 are hybrid banking branches designed to serve both retail customers and, to a limited extent, corporate customers. These relationship management teams market products, and review and approve smaller loans with less credit risks; and

*continues to focus on cross-selling loan products with other products.* For example, when Shinhan Bank lends to small- and medium-sized enterprises, it also explores opportunities to cross-sell retail loans or deposit products to the employees of these enterprises or to provide financial advisory services.

### *Large Corporate and Investment Banking*

Large corporate customers consist primarily of member companies of *chaebols* and financial institutions. Our large corporate loans amounted to ₩33,381 billion as of December 31, 2014. Large corporate customers tend to have better credit profiles than small- and medium-sized enterprises, and accordingly, Shinhan Bank has expanded its focus on these customers as part of its risk management policy.

Shinhan Bank aims to be a one-stop financial solution provider that also partners with its corporate clients in their corporate expansion and growth endeavors. To that end, Shinhan Bank provides a wide range of corporate banking services, including investment banking, including real estate financing, overseas real estate project financing, large development project financing, infrastructure financing, structured financing, equity investments/venture investments, mergers and acquisitions consulting, securitization and derivatives services, including securities and derivative products and foreign exchange trading. Shinhan Bank, through Shinhan Asia Limited, a subsidiary in Hong Kong, also arranges financing for, and offers consulting services to, Korean companies expanding their business overseas, particularly in Asia.

### *Electronic Corporate Banking*

Shinhan Bank offers to corporate customers a web-based total cash management service known as Shinhan Bizbank. Shinhan Bizbank supports substantially all types of banking transactions ranging from basic transaction history inquiries and fund transfers to opening letters of credit, trade finance, payment management, collection management, sales settlement service, acquisition settlement service, business-to-business settlement service, sweeping and pooling. In addition, Shinhan Bank provides customers with integrated and advanced access to its financial services through its InsideBank program, which combines internet banking, capital management services and enterprise resource planning to better serve corporate customers. The Inside Bank program also seeks to provide customized financial services to

meet the comprehensive needs of target corporate customers ranging from conglomerates to small enterprises in various industries, with the goal of enhancing convenience to our corporate customers in accessing our financial services as well as assisting them to strategically manage their funds.

*Corporate Lending Activities*

Our principal loan products for corporate customers are working capital loans and facilities loans. Working capital loans, which include discounted notes and trade financing, are generally loans used for general working

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capital purposes. Facilities loans are provided to finance the purchase of equipment and construction of manufacturing plants. As of December 31, 2014, working capital loans and facilities loans amounted to ₩55,267 billion and ₩32,450 billion, respectively, representing 63.01% and 36.99% of Shinhan Bank's total Won-denominated corporate loans. Working capital loans generally have a maturity of one year, but may be extended on an annual basis for an aggregate term of three years in the case of unsecured loans and five years in the case of secured loans. Facilities loans have a maximum maturity of ten years, are typically repaid in semiannual installments per annum and may be entitled to a grace period not exceeding one-third of the loan term with respect to the first repayment; facilities loans with a term of three years or less may be paid in full at maturity.

Loans to corporations may be unsecured or secured by real estate, deposits or guaranty certificates. As of December 31, 2014, secured loans and guaranteed loans (including loans secured by guaranty certificates issued by credit guarantee insurance funds) accounted for 57.65% and 10.19%, respectively, of Shinhan Bank's Won-denominated loans to small- and medium-sized enterprises. Approximately 45.25% of the corporate loans were secured by real estate as of such date.

When evaluating whether to extend loans to corporate customers, Shinhan Bank reviews their creditworthiness, credit score, value of any collateral and/or third party guarantee. The value of collateral is computed using a formula that takes into account the appraised value of the collateral, any prior liens or other claims against the collateral and an adjustment factor based on a number of considerations including, with respect to property, the average value of any nearby property sold in a court-supervised auction during the previous year. Shinhan Bank revalues collateral when a secured loan is renewed or if a trigger event occurs with respect to the loan in question.

*Pricing*

Shinhan Bank determines the price for its corporate loan products based principally on their respective cost of funding and the expected loss rate based on the borrower's credit risk. As of December 31, 2014, 64.17% of Shinhan Bank's corporate loans with outstanding maturities of one year or more had variable interest rates as determined by the applicable market rates.

More specifically, interest rates on Shinhan Bank's corporate loans are generally determined as follows:

Interest rate = (Shinhan Bank's periodic market floating rate *or* reference rate) *plus* transaction cost *plus* credit spread *plus* risk premium *plus or minus* discretionary adjustment.

Depending on the market condition and the agreement with the borrower, Shinhan Bank may use either its periodic market floating rate or the reference rate as the base rate in determining the interest rate for the borrower. As of December 31, 2014, Shinhan Bank's periodic market floating rates (which are based on a base rate determined for a three-month, six-month, one-year, two-year, three-year or five-year period, as applicable, as derived using Shinhan Bank's market rate system) were 2.13% for three months, 2.17% for six months, 2.18% for one year, 2.23% for two years, 2.31% for three years and 2.49% for five years. As of the same date, Shinhan Bank's reference rate was 6.75%. The reference rate refers to the base lending rate used by Shinhan Bank and is determined annually by Shinhan Bank's Asset & Liability Management Committee based on, among others, Shinhan Bank's funding costs, cost efficiency ratio and discretionary margin.

Transaction cost reflects the standardized transaction cost assigned to each loan product and other miscellaneous costs, including contributions to the Credit Guarantee Fund, and education taxes. The Credit Guarantee Fund is a statutorily created entity that provides credit guarantees to loans made by commercial banks and is funded by mandatory contributions from commercial banks in the amount of approximately 0.2% of all loans made by them.

The credit spread is added to the periodic floating rate to reflect the expected loss based on the borrower's credit rating and the value of any collateral or payment guarantee. In addition, Shinhan Bank adds a risk premium which takes into account the potential of unexpected loss that may exceed the expected loss from the credit rating assigned to a particular borrower.

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A discretionary adjustment rate is added or subtracted to reflect the borrower's current and/or future contribution to Shinhan Bank's profitability. If additional credit is provided by way of a guarantee, the adjustment rate is subtracted to reflect such change in the credit spread. In addition, depending on the price and other terms set by competing banks for similar borrowers, Shinhan Bank may reduce the interest rate to compete more effectively with other banks.

### *Treasury*

Shinhan Bank's treasury division provides funds to all of Shinhan Bank's business operations and ensures the liquidity of its operation. To secure stable long-term funds, Shinhan Bank uses fixed and floating rate notes, debentures, structured financing, and other advanced funding methods. As for overseas funding, Shinhan Bank closely monitors the feasibility of raising funds in currencies other than the U.S. Dollar, such as the Japanese Yen and the Euro. In addition, Shinhan Bank makes call loans and borrows call money in the short-term money market. Call loans are short-term lending among banks and financial institutions in either Korean Won or foreign currencies with a minimum transaction amount of ₩100 million and maturities of typically one day.

### *Securities Investment and Trading*

Shinhan Bank invests in and trades securities for its own accounts in order to maintain adequate sources of liquidity and to generate interest income, dividend income and capital gains. Shinhan Bank's trading and investment portfolios consist primarily of Korean treasury securities and debt securities issued by Korean government agencies, local governments or certain government-invested enterprises, debt securities issued by financial institutions and equity securities listed on the KRX KOSPI Market and KRX KOSDAQ Market of the Korea Exchange. For a detailed description of our securities investment portfolio, see Description of Assets and Liabilities Investment Portfolio.

### *Derivatives Trading*

Shinhan Bank provides to its customers, and to a limited extent, trades for its proprietary accounts, a range of derivatives products, which include:

interest rate swaps, options, and futures relating to Korean Won interest rate risks and LIBOR risks, respectively;

cross-currency swaps largely for Korean Won against U.S. Dollars, Japanese Yen and Euros;

equity and equity-linked options;

foreign currency forwards, swaps and options;

commodity forwards, options and swaps;

credit derivatives; and



KOSPI 200 indexed equity options.

Shinhan Bank's outstanding derivatives commitments in terms of notional amount was ~~₩136,795 billion~~, ~~₩122,842 billion~~ and ₩106,498 billion in 2012, 2013 and 2014, respectively. Such derivative operations generally focus on addressing the needs of Shinhan Bank's corporate clients to enter into derivative contracts to hedge their risk exposure and entering into back-to-back derivatives to hedge Shinhan Bank's risk exposure that results from such client contracts.

Shinhan Bank also enters into derivative contracts to hedge the interest rate and foreign currency risk exposures that arise from its own assets and liabilities. See Description of Assets and Liabilities Derivatives.

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**Table of Contents*****International Business***

Shinhan Bank also engages in treasury and investment activities in international capital markets, principally including foreign currency-denominated securities trading, foreign exchange trading and services, trade-related financial services, international factoring services and foreign banking operations through its overseas branches and subsidiaries. Shinhan Bank aims to become a leading bank in Asia and expand its international business by focusing on further bolstering its overseas network, localizing its overseas operations and diversifying its product offerings, particularly in terms of asset management, in order to meet the various financing needs of its current and potential customers overseas.

***Trust Account Management Services******Overview***

Shinhan Bank's trust account management services involve management of trust accounts, primarily in the form of money trusts. Trust account customers are typically individuals seeking higher rates of return than those offered by bank account deposits. Because deposit reserve requirements do not apply to deposits held in trust accounts as opposed to deposits held in bank accounts, and regulations governing trust accounts tend to be less strict, Shinhan Bank is generally able to offer higher rates of return on trust account products than on bank deposit products. However, in recent years, due to the ongoing low interest environment, Shinhan Bank has not been able to offer attractive rates of return on its trust account products.

Trust account products generally require higher minimum deposit amounts than those required by comparable bank account deposit products. Unlike bank deposit products, deposits in trust accounts are invested primarily in securities (consisting principally of debt securities and beneficiary certificate for real estate financing) and, to a lesser extent, in loans, as the relative shortage of funding sources require that trust accounts be invested in a higher percentage of liquid assets.

Under the Banking Act, the Financial Investment Services and Capital Markets Act and the Trust Act, assets in trust accounts are required to be segregated from other assets of the trustee bank and are unavailable to satisfy the claims of the depositors or other creditors of such bank. Accordingly, trust accounts that are not guaranteed as to principal (or as to both principal and interest) are accounted for and reported separately from the bank accounts. See *Supervision and Regulation*. Trust accounts are regulated by the Trust Act and the Financial Investment Services and Capital Markets Act, and most national commercial banks offer similar trust account products. Shinhan Bank earns income from trust account management services, which is recorded as net trust management fees.

As of December 31, 2012, 2013 and 2014, Shinhan Bank had total trust assets of ₩29,243 billion, ₩26,342 billion and ₩30,986 billion, respectively, comprised principally of securities investments of ₩5,266 billion, ₩5,195 billion and ₩6,239 billion, respectively; real property investments of ₩9,511 billion, ₩4,723 billion and ₩5,913 billion, respectively; and loans with an aggregate principal amount of ₩560 billion, ₩466 billion and ₩434 billion, respectively. Securities investments consisted of corporate bonds, government-related bonds and other securities, primarily commercial paper. As of December 31, 2012, 2013 and 2014, debt securities accounted for 16.3%, 18.3% and 18.9%, respectively, and equity securities constituted 1.7%, 1.4% and 1.3%, respectively, of Shinhan Bank's total trust assets. Loans made by trust accounts are similar in type to those made by bank accounts, except that they are made only in Korean Won. As of December 31, 2012, 2013 and 2014, approximately 51.9%, 54.5% and 57.9%, respectively, of the amount of loans from the trust accounts were collateralized or guaranteed. In making investment from funds received for each trust account, each trust product maintains investment guidelines applicable to each such product which set forth, among other things, company-, industry- and security-specific limitations.

*Trust Products*

In Korea, trust products typically take the form of money trusts, which are discretionary trusts over which (except in the case of a specified money trust) the trustees have investment discretion subject to applicable law

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and is commingled and managed jointly for each type of trust account. The specified money trusts are established on behalf of customers who give specific directions as to how their trust assets should be invested.

Money trusts managed by Shinhan Bank's trust account business amounted to ~~₩15,453 billion, ₩16,830 billion and ₩19,591 billion~~ as of December 31, 2012, 2013 and 2014, respectively.

Shinhan Bank offers variable rate trust products through its retail branch network. As of December 31, 2012, 2013 and 2014, Shinhan Bank's variable rate trust accounts amounted to ~~₩12,289 billion, ₩13,531 billion and ₩16,121 billion~~, respectively, of which principal guaranteed variable rate trust accounts amounted to ~~₩3,163 billion, ₩3,298 billion and ₩3,469 billion~~, respectively. Variable rate trust accounts offer their holders variable rates of return on the principal amount of the deposits in the trust accounts and do not offer a guaranteed return on the principal of deposits, except in the limited cases of principal guaranteed variable rate trust accounts, for which payment of the principal amount is guaranteed. Shinhan Bank charges a lump sum or a fixed percentage of the assets held in such trusts as a management fee, and, depending on the trust products, is also entitled to additional fees in the event of early termination of the trusts by the customer. Korean banks, including Shinhan Bank, are currently allowed to guarantee the principal of the following types of variable rate trust account products: (i) existing individual pension trusts, (ii) new individual pension trusts, (iii) existing retirement pension trusts, (iv) new retirement pension trusts, (v) pension trusts and (vi) employee retirement benefit trusts. Shinhan Bank also has an insignificant amount of guaranteed fixed rate trust products (amounting to ~~₩1.0 billion, ₩1.0 billion and ₩1.0 billion~~ as of December 31, 2012, 2013 and 2014, respectively), which provide to its holders a guaranteed return of the principal as well as a guaranteed fixed rate of return. These products are carry-overs from past offerings, and Shinhan Bank no longer offers guaranteed fixed rate trust products.

**Credit Card Services***Products and Services*

We currently provide our credit card services principally through our credit card subsidiary, Shinhan Card, and to a limited extent, Jeju Bank.

Shinhan Card offers a wide range of credit card and other services, principally consisting of the following:

*credit card services*, which involve providing cardholders with credit up to a preset limit to purchase products and services. Repayment for credit card purchases may be made either (i) on a lump-sum basis, namely, in full at the end of a monthly billing cycle or (ii) on a revolving basis subject to a minimum monthly payment which is the lesser of (x) 10% to 20% of the amount outstanding (depending on the cardholder's credit) or (y) ~~₩50,000~~. Currently, the outstanding credit card balance subject to the revolving basis payments generally accrues interest at the effective annual rates of approximately 6.34% to 24.94%.

*cash advances*, which enable the cardholders to withdraw cash subject to a preset limit from an ATM machine or a bank branch. Repayments for cash advances may be made either on a lump-sum basis or a revolving basis. Currently, the lump-sum cash advances generally accrue interest at the effective annual rates of approximately 7.84% to 27.44% and the revolving cash advances generally accrue interest at a minimum rate of (x) 5% to 20% of the outstanding balance (depending on the cardholder's credit) or (y) ~~₩30,000~~.

*installment purchases*, which provide customers with an option to purchase products and services from select merchants on an installment basis for which repayments must be made in equal amounts over a fixed term ranging from two months to 24 months. Currently, the outstanding installment purchase balances generally accrue interest at the effective annual rates of approximately 9.5% to 20.9%.

*card loans*, which enable cardholders to receive, up to a preset limit, a loan which are generally unsecured. Repayment of card loans is made generally by (i) repaying principal and interest in equal amounts on an installment basis over a fixed term of two to 36 months, (ii) repaying the principal and

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interest amounts in full at maturity, or (iii) making interest-only payments during the initial grace period of typically three months and repaying the principal and interest amounts on a monthly installment basis over the remaining period of typically two to 24 months. Currently, the outstanding card loan balances generally accrue interest at the effective annual rates of approximately 7.6% to 25.9%. Delinquent credit card receivables can also be restructured into loans, which we classify as card loans, and these loans generally accrue interest at the effective annual rates of approximately 17.0% to 27.8% over a fixed term whose maximum is 72 months.

Shinhan Card derives revenues from annual membership fees paid by credit cardholders, interest charged on credit card balances, fees and interest charged on cash advances and card loans, interest charged on late and deferred payments and merchant fees paid by retail and service establishments. Merchant fees and interest on cash advances constitute the largest source of revenue.

The annual membership fees for credit cards vary depending on the type of credit card and the benefits offered thereunder. For standard credit cards, Shinhan Card charges an annual membership fee ranging from ₩2,000 to ₩1,000,000 per credit card, depending on the type of the card and the cardholder profile. Annual membership fees for various affinity and co-branded cards vary from ₩2,000 to ₩1,000,000. If Shinhan Card's customers make cash advances using ATMs of a financial institution other than Shinhan Card, Shinhan Card also charges a usage fee for such cash advances in an amount equivalent to the fees charged by such financial institution for the use of its ATM plus costs to cover Shinhan Card's related administration expenses.

Any accounts that are unpaid when due are deemed to be delinquent accounts, for which Shinhan Card levies a late charge in lieu of the interest rates applicable prior to default. The late charge rate currently ranges from 23.0% to 29.5% per annum.

Merchant discount fees, which are processing fees Shinhan Card charges to merchants, can be up to the regulatory limit of 2.7% of the purchased amount depending on the merchant used, with the average charge being 1.88% in 2014.

Although making payments on a revolving basis is more common in many other countries, this payment method is still in its early stages of development in Korea. Cardholders in Korea are generally required to repay their purchases within approximately 14 to 44 days of purchase depending on their payment cycle, except in the case of installment purchases where the repayment term is typically three to six months. Accounts that remain unpaid after this period are deemed to be delinquent, and Shinhan Card levies late charges on and closely monitors such accounts. For purchases made on an installment basis, Shinhan Card charges interest on unpaid amounts at rates that vary according to the terms of repayment.

Cardholders are required to settle their outstanding balances in accordance with the terms of the credit cards they hold. Cardholders are required to select the monthly settlement date when they open the credit card account and may subsequently change the settlement but no more than once every two months. Settlement dates at or around the end of each month are the most popular since salaries are typically paid at the end of the month.

In addition to credit card services, Shinhan Card also offers check cards, which are similar to debit cards in the United States and many other countries, to retail and corporate customers. A check card can be used at any of the merchants that accept credit cards issued by Shinhan Card and the amount charged to a check card is directly debited from the cardholder's designated bank account. Check cards have a low risk of default and involve minimal funding costs. Although Shinhan Card does not charge annual membership fees on check cards, merchants are charged fees on the amount purchased using check cards at a rate between 1.00% and 1.85%, depending on the type of business, which is lower than the corresponding fee charged for credit card use.



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*Credit Card Products*

Shinhan Card offers a wide range of credit card products tailored for credit cardholders' lives and to satisfy their preferences and needs. Credit card products offered by Shinhan Card include:

cards that provide additional benefits such as frequent flyer miles and reward program points that can be redeemed by the customer for complementary services, prices and cash;

platinum cards and other preferred membership cards, which have higher credit limits and provide additional services in return for higher annual membership fees;

cards with additional features to preferred customers, such as revolving credit cards, travel services and insurance;

cards with fraud detection and security systems to prevent the misuse of credit cards and to encourage the use of credit cards over the Internet;

corporate and affinity cards that are issued to employees or members of particular companies or organizations; and

mobile phone cards allowing customers to conduct wireless credit card transactions through their mobile phones.

*Customers and Merchants*

In addition to internal growth through cross-selling, we seek to enhance our market position by selectively targeting new customers with high net worth and solid credit quality through the use of a sophisticated and market-oriented risk management system. We also seek to provide a wide variety of differentiated products and services tailored to our customers' individualized needs through precision analysis and customer segmentation based on the "big data" we have compiled on our approximately 22 million customers. We have also formed a team dedicated to the "fintech" business by actively pursuing technology developments and strategic alliances with key partners. Shinhan Card screens its credit card applicants and sets individualized credit limits for such applicants according to internal guidelines based on a comprehensive credit scoring system.

The following table sets forth the number of customers of Shinhan Card and the number of merchants at which Shinhan Card can be used for purchases as of the dates indicated.

**As of December 31,**  
**2012            2013            2014**  
**(In thousands, except percentages)**



<b>Shinhan Card:</b>			
Number of credit card holders <sup>(1)</sup>	15,182	13,493	12,578
Personal accounts	15,070	13,385	12,468
Corporate accounts	112	108	110
Active ratio <sup>(2)</sup>	83.6%	93.7%	97.1%
Number of merchants	2,755	2,392	2,491

*Notes:*

- (1) Represents the number of cardholders whose card use is not subject to suspension or termination as of the relevant date.
- (2) Represents the ratio of accounts used at least once within the last six months to the total accounts as of year-end.

*Installment Finance*

Shinhan Card provides installment finance services to customers to facilitate purchases of durable consumer goods such as new and used cars, appliances, computers and other home electronics products. Revenues from

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installment finance operations accounted for 1.9% of Shinhan Card's total operating revenue in 2014. Shinhan Card pays the merchants when Shinhan Card's customers purchase such goods, and the customers remit monthly installment payments to Shinhan Card over a number of months, generally up to 36 months (and, in the case of installment financings for automobile purchases, up to 72 months), as agreed with the customers. For installment finance products for new cars, Shinhan Card historically charged, in addition to interest, an initial financing fee of up to 9.9% of the purchase price, depending on the customer's credit score, the installment period and installment amount. Initial financing fees charged in connection with installment finance products for new cars, however, were abolished effective March 2, 2013 pursuant to the Financial Consumer Report (Automobile Financings) issued by the Financial Supervisory Service on January 29, 2013. Shinhan Card has installment financing arrangements with over 10,000 merchants in Korea, including major car dealers, manufacturers and large retailers with nationwide networks, such as electronics goods stores.

Shinhan Card promptly processes installment financing applications and, based on the extensive credit information it possesses or can access, it is able to offer flexible installment payment terms tailored to individual needs of the customers. Shinhan Card also devotes significant efforts to developing and maintaining its relationships with merchants, which are the most important source of referrals for installment finance customers. Shinhan Card makes prompt payments to merchants for goods purchased by the installment finance customers.

### *Auto Lease*

Shinhan Card currently provides auto leasing financing to retail customers and corporations. Revenues from auto lease operations accounted for 0.8% of Shinhan Card's total operating revenue in 2014.

## ***Securities Brokerage Services***

### *Overview*

Through Shinhan Investment, we provide a wide range of financial investment services to our diversified customer base including corporations, institutional investors, governments and individuals. Financial investment services offered by Shinhan Investment range from securities brokerage services, investment advice and financial planning services, and investment banking services such as underwriting and M&A advisory services. Subject to market conditions, Shinhan Investment also engages in equity- and stock index-linked derivatives sales and brokerage, proprietary trading and brokerage services for futures involving interest rates, currency and commodities as well as foreign exchange margin trading.

As of December 31, 2014, according to internal data, Shinhan Investment's annual market share of Korean equity brokerage market was 6.42% (consisting of 2.40% in the retail segment, 0.75% in the institutional segment and 3.27% in the international segment) in terms of total brokerage volume, ranking second among securities firms in Korea. As of the same date, according to internal data, Shinhan Investment held the fourth largest annual market share in options brokerage segments and the second largest annual market share in the KOSPI 200 futures of 4.98% and 7.87%, respectively, in terms of total brokerage volume with respect to these products.

### *Products and Services*

Shinhan Investment provides principally the following services:

*retail client services.* These services include equity and bond brokerage, investment advisory and financial planning services to retail customers, with a focus on high net worth individuals. The fees generated include brokerage commissions for the purchase and sale of securities, asset management fees, interest income from credit extensions (including in the form of stock subscription loans), margin transaction loans and loans secured by deposited securities.

*institutional client services:*

*brokerage services.* These services include brokerage of stocks, corporate bonds, futures and options provided to Shinhan Investment's institutional and international customers and sale of

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institutional financial products. These services are currently supported by a team of approximately 80 research analysts that specialize in equity, bonds and derivatives research.

*investment banking services.* These services include a wide array of investment banking services to Shinhan Investment's corporate customers, such as domestic and international initial public offerings, mergers and acquisitions advisory services, bond issuances, underwriting, capital increase, asset-backed securitizations, issuance of convertible bonds and bonds with warrants, structured financing, issuance of asset-backed commercial papers and project financings involving infrastructure, real estate and shipbuilding.

Shinhan Investment also engages, to a limited extent, in proprietary trading in equity and debt securities, derivative products and over-the-counter market products.

With respect to brokerage services, in the face of intense competition in the domestic brokerage industry, Shinhan Investment primarily focuses on strengthening profitability through service differentiation and efficient management of its distribution network rather than enlarging its market share indiscriminately through lowering fees and commissions. Shinhan Investment's service differentiation efforts include offering its customers opportunities to purchase stocks in a wide range of countries (currently more than 25 countries), leveraging synergy opportunities afforded by affiliation with other Shinhan entities such as offering brokerage accounts maintained at Shinhan Bank and Shinhan Capital.

With respect to investment banking services, Shinhan Investment concentrates on equity capital markets, debt capital markets, project finance and mergers and acquisitions. To a limited extent, Shinhan Investment also engages in private equity investments through formation of private equity funds by soliciting investors on a private placement basis. To better serve its international customers, Shinhan Investment has established two overseas service centers in Hong Kong and New York.

***Life Insurance Services***

We provide life insurance products and services primarily through Shinhan Life Insurance. Shinhan Life Insurance provides its services through diversified distribution channels consisting of financial planners, telemarketers, agency marketers and bancassurance specialists. As of December 31, 2012, 2013 and 2014, Shinhan Life Insurance had total assets of ₩16,943 billion, ₩19,379 billion and ₩21,940 billion and net profits of ₩209 billion, ₩84 billion and ₩81 billion, respectively. In 2015, we expect the life insurance industry to continue to be adversely affected by recent unfavorable changes in applicable regulations, such as the lowering of the cap on deferral of expenses incurred in connection with new insurance contracts, which regulations were implemented in 2013, and to the extent the low interest rate environment persists, we expect Shinhan Life Insurance to experience limited growth, if any, in net profit.

***Other Services***

Through our other subsidiaries, we also provide asset management, leasing and equipment financing, regional banking, savings banking, loan collection and credit reporting, collective investment administration and financial system development services. Through Shinhan Private Equity (in addition to Shinhan Investment), we are also engaged in private equity investments through formation of private equity funds by soliciting investors on a private placement basis.

***Asset Management Services***

In addition to personalized wealth management services provided as part of our private banking and securities brokerage services, we also provide asset management services through Shinhan BNP Paribas Asset Management, a joint venture with BNP Paribas Investment Partners, of which we and BNP Paribas Investment Partners hold 65:35 interests, respectively. Shinhan BNP Paribas Asset Management ranked fifth among asset

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managers in Korea in terms of assets under management as of December 31, 2014, and provides a wide range of investment products, including traditional equity/fixed income funds as well as alternative investment products, to retail and institutional clients. As a joint venture with BNP Paribas Investment Partners, we believe Shinhan BNP Paribas Asset Management derives significantly benefits from BNP Paribas' s global network of investment professionals and expertise in the asset management industry. As of December 31, 2014, Shinhan BNP Paribas Asset Management had assets under management amounting to approximately ₩35,412 billion. To a limited extent, Shinhan Investment also provides asset management services for discretionary accounts, see Securities Brokerage Services.

In 2015, we expect the activity level in the asset management industry, including fund formation activities, to remain similar to 2014 due to uncertainties surrounding the domestic and international economy, with the exception of the discretionary investment market, which is expected to continue to grow due to expanded use of such services by large institutional investors, such as the National Pension Service.

### *Leasing and Equipment Financing*

We provide leasing and equipment financing services to our corporate customers mainly through Shinhan Capital. Shinhan Capital provides customers with leasing, installment financing and new technology financing, equipment leasing, and corporate credit financing. Shinhan Capital' s strength has traditionally been in leasing of ships, printing machines, automobiles and other specialty items, but it also offers other leasing and financing services, such as corporate restructuring services for financially troubled companies, project financing for real estate and infrastructure development, corporate leasing and equipment financing.

### *Regional Banking*

We provide regionally focused commercial banking services, primarily in Jeju Island of Korea, through a majority-owned banking subsidiary, Jeju Bank. Jeju Bank provides retail banking, corporate banking, treasury and trust account management services through a network of 38 branches as of December 31, 2014.

### *Savings Banking*

We provide savings banking services in accordance with the Mutual Savings Bank Act to customers that generally would not, due to their credit profile, qualify for our commercial banking services or who seek higher returns on their deposits than those offered by our commercial banking subsidiaries, through Shinhan Savings Bank, which was established in December 2011. Shinhan Savings Bank offers savings and other deposit products with relatively higher interest rates and loans (usually in relatively small amounts and on customer-tailored terms and including loans for which we receive credit support from the Government) primarily to small- to medium-sized enterprises and low income households who would not generally qualify for our commercial banking services. Shinhan Savings Bank has assumed the assets and liabilities of Tomato Savings Bank, which we acquired in January 2012, and has merged into Yehanbyoul Savings Bank, which we acquired in March 2013, with Yehanbyoul Savings Bank as the surviving entity with its name changed to Shinhan Savings Bank. Both Tomato Savings Bank and Yehanbyoul Savings Bank were facing liquidity troubles due to difficulties in the real estate project financing business as a result of the prolonged slump in the Korean real estate market at the time we acquired them. We closely monitor the business activities and product offerings of Shinhan Savings Bank to ensure its financial soundness.

### *Loan Collection and Credit Reporting*

We centralize credit collection and credit reporting operations for our subsidiaries through Shinhan Credit Information Co. Ltd., which also provides similar services to third party customers. Shinhan Credit Information's services include debt collection, credit inquiries, credit reporting, civil application/petition services and process agent services, among others. Shinhan Credit Information also manages participants in credit recovery programs

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and provides support to the Kookmin Happy Fund, which is a Government-established fund that supports retail borrowers with low credit scores by purchasing defaulted loans from creditors or providing credit guarantees to enable such borrowers to refinance at lower rates.

*Collective Investment Administration Services*

We provide integrated collective investment administration services through Shinhan AITAS Co., Ltd. Shinhan AITAS provides general management service, asset management systems, accounting systems and trading systems to asset management companies and institutional investors. The target customers for these collective investment administration services are asset managers, investment advisors and institutional investors, and Shinhan AITAS seeks to provide a comprehensive service package including the computation of the reference value for funds, evaluation of fund performance, provision of trading systems and fund-related legal administrative services.

*Private Equity*

To a limited extent, through Shinhan Private Equity, we are also engaged in private equity investments through formation of private equity funds. The private equity funds receive funding from investors on a private placement basis, which funds are then invested in equity securities in companies for a variety of reasons, including management control, business turnaround or corporate governance improvements.

*Financial System Development Services*

We provide financial system development services through Shinhan Data Systems, which offers system integration, system management, IT outsourcing, business process outsourcing and IT consulting services.

**Our Distribution Network**

We offer a wide range of financial services to retail and corporate customers through a variety of distribution networks and channels established by our subsidiaries. The following table presents the geographical distribution of our distribution network based on the branch offices and other distribution channels of our principal subsidiaries, as of December 31, 2014.

	Shinhan Bank	Jeju Bank	Shinhan Card	Shinhan Investment	Shinhan Life Insurance	Total
<i>Distribution Channels in Korea</i> <sup>(1)</sup>						
Seoul metropolitan	377	2	8	47	46	480
Kyunggi province	200		5	13	31	249
Six major cities:	166	1	7	20	47	241
Incheon	54		1	3	17	75
Busan	39	1	2	6	11	59
Kwangju	12		1	2	6	21
Taegu	28		1	4	5	38
Ulsan	13		1	2	2	18
Taejon	20		1	3	6	30
Sub-total	743	3	20	80	124	970



Others	158	35	13	15	62	283
Total	901	38	33	95	186	1,253

*Note:*

(1) Includes our main office and those of our subsidiaries.

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### ***Banking Service Channels***

Our banking services are primarily provided through an extensive branch network, specializing in retail and corporate banking services, as complemented by self-service terminals and electronic banking, as well as an overseas services network.

As of December 31, 2014, Shinhan Bank's branch network in Korea comprised of 901 service centers, consisting of our headquarters, 675 retail banking service centers, nine corporate banking service centers primarily designed to serve large corporate customers and 216 hybrid banking branches designed to serve retail as well as small-business corporate customers. Shinhan Bank's banking branches are designed to provide one-stop banking services tailored to their respective target customers.

### ***Retail Banking Channels***

In Korea, many retail transactions are conducted in cash or with credit cards, and conventional checking accounts are generally not offered or used as widely as in other countries such as the United States. As a result, an extensive retail branch network plays an important role for Korean banks as customers generally handle most transactions through bank branches. Recently, one of the key initiatives at Shinhan Bank has been to target high net worth individuals through private banking. Our private banking services are provided principally through private banking relationship managers who, within target customer groups, assist clients in developing individual investment strategies. We believe that such relationship managers help us foster enduring relationships with our clients. Private banking customers also have access to Shinhan Bank's retail branch network and other general banking products Shinhan Bank offers through its retail banking operations.

### ***Corporate Banking Channels***

Shinhan Bank currently provides corporate banking services through corporate banking service centers primarily designed to serve large corporate customers and hybrid banking branches designed to serve retail as well as small-business corporate customers. Small- and medium-sized enterprises have traditionally been Shinhan Bank's core corporate customers and we plan to continue to maintain Shinhan Bank's strength vis-à-vis these customers.

### ***Self-Service Terminals***

In order to complement its banking branch network, Shinhan Bank maintains an extensive network of automated banking machines, which are located in branches and in unmanned outlets. These automated banking machines consist of ATMs, cash dispensers and passbook printers. As of December 31, 2014, Shinhan Bank had 33 cash dispensers and 7,434 ATMs. Shinhan Bank has actively promoted the use of these distribution outlets in order to provide convenient service to customers, as well as to maximize the marketing and sales functions at the branch level, reduce employee costs and improve profitability. In 2014, automated banking machine transactions accounted for a substantial portion and a majority of total deposit and withdrawal transactions of Shinhan Bank in terms of the number of transactions and fee revenue generated, respectively.

### ***Electronic Banking***

Shinhan Bank's Internet banking services are more comprehensive than those available at the counter, including such services as 24-hour account balance posting, real-time account transfer, overseas remittance and loan requests. Shinhan Bank also offers mobile banking services in order to enable customers to make speedy, convenient and secure banking transactions using mobile phones. As the purpose of electronic banking is primarily cost-saving rather than

profit generation, the substantial majority of Shinhan Bank's electronic banking transactions do not generate fee income.

**Table of Contents***Overseas Distribution Network*

The table below sets forth Shinhan Bank's overseas banking subsidiaries and branches as of December 31, 2014.

<b>Business Unit</b>	<b>Location</b>	<b>Year Established or Acquired</b>
<i>Subsidiaries</i>		
Shinhan Asia Ltd.	Hong Kong SAR, China	1982
Shinhan Bank Europe GmbH <sup>(1)</sup>	Germany	1994
Shinhan Bank America	New York, U.S.A.	2003
Shinhan Bank (China) Limited	Beijing, China	2008
Shinhan Khmer Bank PLC	Cambodia	2007
Shinhan Bank Kazakhstan Limited	Kazakhstan	2008
Shinhan Bank Canada	Toronto, Canada	2009
Shinhan Bank Japan <sup>(2)</sup>	Tokyo, Japan	2009
Shinhan Bank Vietnam Ltd. <sup>(3)</sup>	Ho Chi Minh City, Vietnam	2011
<i>Branches</i>		
New York	U.S.A.	1989
Singapore	Singapore	1990
London	United Kingdom	1991
Mumbai	India	1996
Hong Kong	China	2006
New Delhi	India	2006
Kancheepuram	India	2014
Pune	India	2014
<i>Representative Offices</i>		
Mexico	Mexico City, Mexico	2008
Uzbekistan	Tashkent, Uzbekistan	2009
Myanmar	Yangon, Myanmar	2013
Poland <sup>(1)</sup>	Wroclaw, Poland	2014

*Notes:*

- (1) Shinhan Bank Europe GmbH established a representative office in Poland in 2014.
- (2) While Shinhan Bank established the subsidiary in Japan in 2009, Shinhan Bank has provided banking services in Japan through a branch structure since 1986.
- (3) Prior to the establishment of this subsidiary in 2011, Shinhan Bank had provided banking services in Vietnam through a branch since 1995.

In addition, in April 2015, we obtained the approval from financial regulatory authorities in Indonesia for our acquisition of a 40% equity interest in PT. Bank Metro Express, a small-sized bank in Indonesia. We expect the

closing for this transaction will occur in the third quarter of 2015.

Currently, our overseas subsidiaries and branches are primarily engaged in trade financing and local currency funding for Korean companies and Korean nationals in the overseas markets, as well as providing foreign exchange services in conjunction with Shinhan Bank's headquarters. On a limited basis, these overseas branches and subsidiaries also engage in investment and trading of securities of foreign issuers. In the future, as part of our globalization efforts, we plan to expand our coverage of local customers in the overseas markets by providing a wider range of services in retail and corporate banking, and to that end, we have increasingly established subsidiaries in lieu of branches in select markets in order to enhance our presence and enable a greater flexibility in our service offerings in these markets.

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### ***Credit Card Distribution Channels***

Shinhan Card primarily uses three distribution channels to attract new credit card customers: (i) the banking and credit card branch network, (ii) sales agents, and (iii) business partnerships and affiliations with vendors.

The branch network for our credit card operations consisted of 901 branches as of December 31, 2014 of Shinhan Bank and 33 card sales branches of Shinhan Card. The use of the established distribution network of Shinhan Bank is part of the group-wide cross-selling efforts of selling credit card products to existing banking customers. In 2014, the number of new cardholders acquired through our banking distribution network accounted for approximately 17.7% of the total number of new cardholders. We believe that the banking distribution network will continue to provide a stable and low-cost venue for acquiring high-quality credit cardholders.

The sales agents represented the most significant source of Shinhan Card's new cardholders in 2014, and the number of new cardholders acquired through sales agents accounted for approximately 59.9% of the total number of Shinhan Card's new cardholders in 2014. As of December 31, 2014, Shinhan Card had 4,098 sales agents, who were independent contractors. These sales agents assist prospective customers with the application process and customer service. Compensation of these sales agents is tied to the transaction volume and the repayment patterns of the customers introduced by them, and we believe this system helps to minimize credit risk and enhance profitability.

As a way of acquiring new cardholders, Shinhan Card also has business partnership and affiliation arrangements with a number of vendors, including gas stations, major retailers, airlines and telecommunication and Internet service providers. Shinhan Card plans to continue to leverage its alliances with such vendors to attract new cardholders.

In November 2014, as an initial step to exploring potential opportunities overseas Shinhan Card established its first overseas subsidiary in Kazakhstan, LLP MFO Shinhan Finance, as Kazakhstan was deemed to have relatively low entry barriers to foreign financial institutions, high growth potential for retail operations and the possibility of leveraging Shinhan Bank's network. LLP MFO Shinhan Finance, a wholly-owned subsidiary of Shinhan Card, is expected to obtain its business license by the end of 2015, following which it is expected to receive capital contributions from Shinhan Card and engage in retail operations, including installment financing, credit loans and financing leases.

### ***Securities Brokerage Distribution Channels***

Our securities brokerage services are conducted principally through Shinhan Investment. As of December 31, 2014, Shinhan Investment had 95 service centers nationwide, and two overseas subsidiaries based in New York and Hong Kong to service our corporate customers.

Approximately 49.5% of our brokerage branches are located in the Seoul metropolitan area with a focus on attracting high net worth individual customers as well as enhancing synergy with our retail and corporate banking branch network. We plan to continue to explore new business opportunities, particularly in the corporate customer segment, through further cooperation between Shinhan Investment and Shinhan Bank.

### ***Insurance Sales and Distribution Channels***

We sell and provide our insurance services primarily through Shinhan Life Insurance. Shinhan Life Insurance, in addition to distributing bancassurance products through our bank branches, also distributes a wide range of life insurance products through its own branch network, an agency network of financial planners and telemarketers, as well as through the Internet. As of December 31, 2014, Shinhan Life Insurance had 186 branches and 13 customer

support centers. These branches are staffed by financial planners, telemarketers, agent marketers and bancassurance to meet the various needs of our insurance and lending customers. Our group-wide

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customer support centers arrange for policy loans (namely loans secured by the cash surrender value of the underlying insurance policy) for our insurance customers and, to a limited extent, other loans to other customers, and also handle insurance payments.

## **Information Technology**

We dedicate substantial resources to maintaining a sophisticated information technology system to support our operations management and provide high quality customer service. Our information and technology system is operated at a group-wide level based on a comprehensive group-wide information collection and processing. We also operate a single group-wide enterprise information technology system known as enterprise data warehouse for customer relations management capabilities, risk management systems and data processing, which is designed to maximize synergy among our subsidiaries. We continually upgrade our group-wide information technology system in order to apply the best-in-class technology to our risk management systems to reflect the changes in our business environment as well as enhance differentiation from our competitors.

At the subsidiary level, we also continue to upgrade the information technology systems for each of our subsidiaries to enhance the quality of our customer service specific to such subsidiary and thereby bolsters their respective competitiveness, including with respect to electronic and mobile banking (including by means of smartphones), online consultation, expanded sales services and customized informational services. In addition, we have recently strengthened our indirect service channels through a major upgrade of the corporate online banking services and expansion of mobile phone-based product offerings and sales and service networks in light of the growing base of customers who increasingly access financial services through their mobile phones.

In addition, we have established a groupwide customer credit rating system to enhance precision in assessing the creditworthiness of our customers and developed information technology systems to bolster our market leadership in retirement planning services in light of the rapidly aging demographics in Korea. Furthermore, we have expanded information technology systems to support the sales and operational capabilities of our overseas subsidiaries and branches through a global customer management system as well as provide country-specific financial services.

In 2013, we completed the construction of the Integrated Data Center, which is responsible for comprehensive management of information technology systems for our subsidiaries on a groupwide basis. This center ensures a stable use of a central information processing facilities for at least 15 years and is designed to maximize operational and cost efficiency as well as enhance information security by combining the various data centers previously used by our subsidiaries. All of our subsidiaries have completed relocation of their information management capabilities to this center by the first half of 2014.

In order to enhance security and trustworthiness of the financial services provided by us, we continually seek to enhance a group-wide set of standards for information security and upgrading the related systems. In 2008, we established group-wide information systems and policies, which have since been continually updated and upgraded. In 2014, we further upgraded the groupwide information security control tower to a best-in-class level and replaced most of our internal information security staff with highly qualified outside experts in order to reinforce our security defense capabilities in the event of cyber breaches. In addition, we have newly established a team within our group to provide specialized data protection and related support services to our smaller operating subsidiaries, and we take active measures to preemptively forestall any security breaches through mock trials.

The information technology system for each of our subsidiaries is currently backed up on a real-time basis. In 2014, we converted the pre-existing data center to a back-up and disaster recovery center for all our subsidiaries operations in order to provide customer services in a continued seamless manner even in the case of an interruption at Shinhan



Data Center. We believe that our centralized back-up systems enable more efficient back-up at a higher level of security.

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**Table of Contents****Competition**

Competition in the Korean financial services industry is, and is likely to remain, intense, including as a result of the sustained low interest rate environment (which narrows opportunities to make profit based on the spread between lending rates and funding rates), the continuing sluggishness in the general economy, the growing maturation and saturation of the industry as a whole, the entry of new market participants and deregulation, among others.

In the banking sector, Shinhan Bank competes principally with other national commercial banks in Korea, but also faces competition from a number of additional banking institutions, including branches and subsidiaries of foreign banks operating in Korea, regional banks, government-owned development banks and Korea's specialized banks, such as Korea Development Bank, the Industrial Bank of Korea and the National Association of Agriculture and Fisheries, as well as various other types of financial service providers, including savings institutions (such as mutual savings and finance companies, credit unions and credit cooperatives), investment companies (such as securities brokerage firms, merchant banking corporations and asset management companies) and life insurance companies. As of December 31, 2014, Korea had seven major nationwide domestic commercial banks (including Citibank Korea Inc. and Standard Chartered Bank Korea Limited, both of which are domestic commercial banks acquired by global financial institutions), six regional commercial banks and branches and subsidiaries of 40 foreign banks. Foreign financial institutions, many of which have greater experiences and resources than we do, may continue to enter the Korean market and compete with us in providing financial products and services either by themselves or in partnership with existing Korean financial institutions.

In the small- and medium-sized enterprise and retail banking segments, which have been Shinhan Bank's traditional core businesses, competition is expected to increase further. In recent years, Korean banks, including Shinhan Bank, have increasingly focused on stable asset growth based on quality credit, such as corporate borrowers with high credit ratings, loans to SOHO with high levels of collateralization, and mortgage and home equity loans within the limits of the prescribed loan-to-value ratios and debt-to-income ratios. This largely shared shift in focus toward stable growth based on less risky assets has intensified competition as banks compete for the same limited pool of quality credit by engaging in price competition or by other means although Shinhan Bank has traditionally focused, and will continue to focus, on enhancing profitability rather than increasing asset size or market share, and has avoided, to the extent practicable, engaging in price competition by way of lowering lending rates. In addition, such competition may result in lower net interest margin and reduced overall profitability, especially if the low interest rate environment were to continue for a significant period of time. Therefore, if competing financial institutions seek to expand market share by lowering their lending rates, Shinhan Bank may suffer customer loss, especially among customers who select their lenders principally on the basis of lending rates. In response thereto or for other strategic reasons, Shinhan Bank may subsequently lower its lending rates to stay competitive, which could lead to a decrease in its net interest margins and outweigh any positive impact on the net interest margin from a general rise in market interest rates. Any future decline in Shinhan Bank's customer base or its net interest margins could have an adverse effect on its results of operations and financial condition.

In the credit card sector, Shinhan Card competes principally with existing monoline credit card companies, credit card divisions of commercial banks, consumer finance companies, other financial institutions and, recently, credit card service providers allied with mobile telecommunications service providers in Korea. Competition has been historically intense in this sector and the market has shown signs of saturation as existing and new credit card service providers make significant investments and engage in aggressive marketing campaigns and promotions to acquire new customers and target customers with high credit quality. While competition has subsided somewhat recently due to stricter government regulations, such as curbs on excessive marketing expenses, competition remains intense and credit card issuers may continue to compete with Shinhan Card for customers by offering lower interest rates and fees, higher credit limits, more attractive promotions and incentives and alternative products such as phone cards, gift cards

and low-interest consumer loan products. As a result, Shinhan Card may lose customers or service opportunities to competing credit card issuers and/or incur

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higher marketing expenses. In addition, the Government regulations adopted in 2012 mandating lower merchant fees chargeable to small- and medium-sized businesses and the Government guidelines issued in 2013 suggesting lower standard interest rates for cash advances and card loans have reduced and are likely to continue to limit the revenues of credit card companies, including Shinhan Card. Furthermore, the Government's recent guidelines to bolster consumer protection and protect customers' personal data in the aftermath of data leaks at certain credit companies (not including Shinhan Card) may result in additional compliance costs for Shinhan Card. Customer attrition, together with any further lowering of fees or reduction in base and market interest rates and/or additional expenses from more extensive marketing and promotional campaigns that Shinhan Card might implement to acquire and retain customers, could reduce its revenues and earnings. Furthermore, the average credit quality of Shinhan Card's customers may deteriorate if customers with higher credit quality borrow from our competitors rather than Shinhan Card and it may become more difficult for Shinhan Card to attract and maintain quality customers. In general, the growth, market share and profitability of Shinhan Card's operations may decline or become negative as a result of market saturation in this sector, interest rate competition, pressure to lower fee rates and incur higher marketing expenses, as well as Government regulation and social and economic developments in Korea that are beyond our control, such as changes in consumer confidence levels, spending patterns or public perception of credit card usage and consumer debt. If Shinhan Card fails to maintain or attract new cardholders or increase the card usage by existing customers or experiences deterioration in its asset quality and a rise in delinquency, our business, financial condition and results of operations may be adversely affected.

In other financial services sectors, our other subsidiaries also compete in a highly fragmented market. Some of our competitors, particularly the major global financial institutions, have greater experience and resources than we do.

Consolidation among our rival institutions may also add competition in the markets in which we and our subsidiaries conduct business. The Korean banking industry may undergo further consolidation either voluntarily or as part of government-led initiatives, including privatization, although the Government announced in March 2013 that it would no longer pursue privatization of Korea Development Bank and Industrial Bank of Korea. Some of the financial institutions resulting from these developments may, by virtue of their increased size, expanded business scope and more efficient operations, provide greater competition for us. For example, partly to facilitate the sale of Government-invested members of the former Woori Financial Group which had not materialized despite a prolonged attempt to sell them as a whole, beginning in 2013 the Government has promoted the sale of such members in three separate groups (namely, commercial banking, regional banking, and securities and investment). As a result, the securities and investment members of the former Woori Financial Group (including Woori Investment & Securities) were sold to other domestic financial institutions in the first half of 2014 and its regional banking members (namely, Kyongnam Bank and Gwangju Bank) were sold to other domestic financial institutions in October 2014. In November 2014, Woori Financial Group was dissolved and merged into Woori Bank, with all the remaining subsidiaries of the former Woori Financial Group having been converted into subsidiaries of Woori Bank. The Government continues to seek to sell Woori Bank, and the outlook for such sale remains uncertain. If one of major competitors or a foreign financial institution were to acquire Woori Bank or any of its major operating subsidiaries, the consolidated entity may have a greater scale of operations, including a larger customer base, and financial resources than us, which may hurt our ability to compete effectively. In addition, in April 2013, Korea Exchange Bank became part of Hana Financial Group after acquisition of the former by the latter in February 2012, and in October 2014, Korea Exchange Bank entered into an agreement to be merged into Hana Bank, one of the major commercial banks in Korea. Any of these developments may place us at a competitive disadvantage and outweigh any potential benefit to us in the form of opportunities to acquire new customers who are displeased with the level of services at the newly reorganized entities or to provide credit facilities to corporate customers who wish to maintain relationships with a wide range of banks in order to diversify their sources of funding.

As the Korean economy further develops and new business opportunities arise, more competitors may enter the financial services industry. Recently, banks are beginning to compete for new customers and competition between bank-operated credit card companies and independent card companies may increase substantially. For

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example, as part of the aforementioned privatization efforts by the Government, Woori Card may be sold to another major credit card company, in which case it is possible that a credit card company comparable to Shinhan Card in terms of asset size and customer base may newly emerge. Furthermore, as online service providers with large-scale user networks, such as Daum Kakao, make significant inroads in providing virtual payment services through a system based on a growing convergence of financial services and technology commonly referred to as fintech, competition for online customers is growing not just among commercial banks, but also from online service providers.

Accordingly, the commercial banks are facing increasing pressure to upgrade their service platforms to attract and maintain online users, which represents a growing customer base compared to traditional customers who have primarily conducted banking in-person at physical banking branches. In addition, large non-financial institutions, such as mobile telecommunications companies, which on a combined basis service most of the Korean population, may expand entry into the Korean credit card and consumer finance businesses by way of convergence with the existing and future mobile telephone networks. Accordingly, a widespread consumer acceptance of mobile phone payment services in lieu of credit card services could add to competitive threat to the existing credit card service providers, including our credit card subsidiary.

Recently, following the global financial crisis, the Government has subjected Korean financial institutions to stricter regulatory requirements and guidelines in areas of asset quality, capital adequacy, liquidity and residential and other lending practices, which has had a dampening effect on competition. The Financial Services Commission implemented the capital requirements of Basel III, the minimum requirements of which are being phased in sequentially from December 1, 2013 and will become fully effective on January 1, 2019, based on the guidelines set forth in the amended Regulation on the Supervision of the Banking Business and the Detailed Regulation on the Supervision of the Banking Business. In addition, the Financial Services Commission announced its plan to implement Basel III requirements relating to liquidity coverage ratio and countercyclical capital buffer in 2015 and 2016, respectively, among other Basel III requirements. However, there is no assurance that these measures will continue to curb competition or that the Government will not reverse or reduce such measures or introduce other deregulatory measures, which may further intensify competition in the Korean financial services industry.

If we are unable to compete effectively in the changing business and regulatory environment, our profit margin and market share may erode and our future growth opportunities may become limited, which could adversely affect our business, financial condition and results of operations. See Item 3.D. Risk Factors Risks Relating to Our Overall Business Competition in the Korean financial services industry is intense, and may further intensify as a result of further deregulation and Item 4.B. Business Overview Supervision and Regulation Financial Investment Services and Capital Markets Act.

**Table of Contents****Description of Assets and Liabilities****Loans**

As of December 31, 2014, our total gross loan portfolio was ₩223,879 billion, which represented an increase of 7.64% from ₩207,987 billion at December 31, 2013. The increase in our portfolio primarily reflects a 6.75% increase in corporate loans and a 10.08% increase in retail loans.

**Loan Types**

The following table presents our loans by type for the periods indicated. Except where specified otherwise, all loan amounts stated below are before deduction for loan loss allowances. Total loans reflect our loan portfolio, including past due amounts.

	2010	2011	As of December 31, 2012			2013	2014
	(In billions of Won)						
<b>Corporate</b>							
Corporate loans <sup>(1)</sup>	₩ 95,835	₩ 98,598	₩ 101,162	₩ 102,823	₩ 112,145		
Public and other <sup>(2)</sup>	2,771	4,930	3,107	2,525	2,135		
Loans to banks <sup>(3)</sup>	1,467	2,557	4,557	6,103	4,684		
Lease financing	1,555	1,639	1,699	1,721	1,844		
<b>Total Corporate</b>	<b>101,628</b>	<b>107,724</b>	<b>110,525</b>	<b>113,172</b>	<b>120,808</b>		
<b>Retail</b>							
Mortgages and home equity	40,073	44,399	46,130	46,908	50,652		
Other retail <sup>(4)</sup>	24,901	25,052	28,407	30,242	34,278		
<b>Total Retail</b>	<b>64,974</b>	<b>69,451</b>	<b>74,537</b>	<b>77,150</b>	<b>84,930</b>		
Credit cards	17,647	17,880	17,854	17,665	18,141		
<b>Total loans<sup>(5)</sup></b>	<b>₩ 184,249</b>	<b>₩ 195,055</b>	<b>₩ 202,916</b>	<b>₩ 207,987</b>	<b>₩ 223,879</b>		

**Notes:**

- (1) Consists primarily of working capital loans, general purpose loans, bills purchased and trade-related notes and excludes loans to public institutions and commercial banks.
- (2) Consists of working capital loans and loan facilities to public institutions and non-profit organizations.
- (3) Consists of interbank loans and call loans.
- (4) Consists of general unsecured loans and loans secured by collateral other than housing to retail customers.

(5) As of December 31, 2010, 2011, 2012, 2013 and 2014, approximately 89.25%, 88.76%, 89.59%, 89.99% and 89.08% of our total gross loans, respectively, were Won-denominated.

***Loan Portfolio***

The total exposure of us or our banking subsidiaries to any single borrower and exposure to any single group of companies belonging to the same conglomerate is limited by law to 20% and 25%, respectively, of the Net Total Equity Capital (as defined in Supervision and Regulation ).



**Table of Contents***Twenty Largest Exposures by Borrower*

As of December 31, 2014, our 20 largest exposures, consisting of loans, securities and guarantees and acceptances, totaled ₩40,016 billion and accounted for 14.28% of our total exposures. The following table sets forth our total exposures to these top 20 borrowers as of December 31, 2014.

	Loans in Won Currency	Loans in Foreign Currency	Securities	Guarantees and Acceptances	Others	Total Exposure	Impaired Loans and Guarantees and Acceptances
	(In billions of Won)						
Ministry of Strategy and Finance	₩	₩	₩ 7,338	₩	₩	₩ 7,338	₩
The Bank of Korea	1,730		5,103			6,833	
Korea Deposit Insurance Corporation			2,995			2,995	
Korea Development Bank	15	24	2,805			2,844	
Industrial Bank of Korea	535		1,702			2,237	
Hyundai Heavy Industries Co., Ltd.	39	225	81	1,832		2,177	
Korea Finance Corporation			1,764			1,764	
Korea Land & Housing Corporation			1,474			1,474	
Woori Bank	302	77	1,052			1,431	
Samsung Heavy Industries Co., Ltd.	270	11	20	942		1,243	
Hyundai Samho Heavy Industries Co., Ltd.		64	38	1,103		1,205	
Korea Securities Finance Corporation			1,188			1,188	
Kookmin Bank	280		690			970	
Hyundai Steel Co., Ltd.	510	277	153	28		968	
Nonghyup Bank	499		445	9		953	
Hana Bank	115	10	820			945	
KB Kookmin Card Co., Ltd.			931			931	
Korea Housing Finance Corporation.			884			884	
Korea Electric Power Corporation	2		827	16		845	
Woori Card Co., Ltd.			791			791	
<b>Total</b>	<b>₩4,297</b>	<b>₩ 688</b>	<b>₩ 31,101</b>	<b>₩ 3,930</b>	<b>₩</b>	<b>₩ 40,016</b>	<b>₩</b>



**Table of Contents***Exposure to Main Debtor Groups*

As of December 31, 2014, 12.85% of our total exposure was to the 42 main debtor groups as identified by the Governor of the Financial Supervisory Service, which are largely comprised of *chaebols*. The following table shows, as of December 31, 2014, our total exposures to the ten main debtor groups to which we have the largest exposure.

Main Debtor Groups	Loans in Won Currency	Loans in Foreign Currency	Securities	Guarantees and Acceptances	Others	Total Exposure	Amounts of Impaired Loans and Guarantees and Acceptances
							(In billions of Won)
Hyundai Motors	₩ 1,372	₩ 1,280	₩ 1,836	₩ 364	₩	₩ 4,852	₩
Samsung	642	1,182	1,003	1,672		4,499	
Hyundai Heavy Industries	154	491	148	3,671		4,464	
SK	457	967	951	1,204		3,579	
Lotte	348	828	1,340	398		2,914	
LG	657	290	400	762		2,109	
LS	185	353	163	602		1,303	
POSCO	214	407	357	189		1,167	
GS	238	387	177	261		1,063	
Hyosung	248	500	5	134		887	8
<b>Total</b>	<b>₩ 4,515</b>	<b>₩ 6,685</b>	<b>₩ 6,380</b>	<b>₩ 9,257</b>	<b>₩</b>	<b>₩ 26,837</b>	<b>₩ 8</b>

*Loan Concentration by Industry*

The following table shows the aggregate balance of our corporate loans by industry concentration as of December 31, 2014.

Industry	Aggregate Loan Balance	Percentage of Total Corporate Loan Balance
	(In billions of Won)	(Percentages)
Manufacturing	₩ 37,266	30.85%
Retail and wholesale	16,046	13.28
Real estate, leasing and service	19,438	16.09
Construction	3,649	3.02
Hotel and leisure	6,010	4.97

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Finance and insurance		9,498	7.86
Transportation, storage and communication		4,602	3.81
Other service		12,548	10.39
Other		11,751	9.73
Total	₩	120,808	100.00%

**Table of Contents****Maturity Analysis**

The following table sets out the scheduled maturities (presented in terms of time remaining until maturity) of our loan portfolio as of December 31, 2014. The amounts below are before deduction of attributable loan loss reserves.

	<b>As of December 31, 2014</b>			
	<b>1 Year or Less</b>	<b>Over 1 Year but Not More Than 5 Years</b>	<b>Over 5 Years</b>	<b>Total</b>
	<b>(In billions of Won)</b>			
<b>Corporate:</b>				
Corporate loans	₩ 81,865	₩ 25,630	₩ 4,650	₩ 112,145
Public and other	1,566	495	74	2,135
Loans to banks	4,022	530	132	4,684
Lease financing	659	1,169	16	1,844
<b>Total corporate</b>	<b>₩ 88,112</b>	<b>₩ 27,824</b>	<b>₩ 4,872</b>	<b>₩ 120,808</b>
<b>Retail:</b>				
Mortgage and home equity	₩ 8,237	₩ 11,461	₩ 30,954	₩ 50,652
Other retail	25,855	6,704	1,719	34,278
<b>Total retail</b>	<b>₩ 34,092</b>	<b>₩ 18,165</b>	<b>₩ 32,673</b>	<b>₩ 84,930</b>
<b>Credit cards</b>	<b>₩ 16,463</b>	<b>₩ 1,406</b>	<b>₩ 272</b>	<b>₩ 18,141</b>
<b>Total loans</b>	<b>₩ 138,667</b>	<b>₩ 47,395</b>	<b>₩ 37,817</b>	<b>₩ 223,879</b>

We may roll over our corporate loans (primarily consisting of working capital loans and facility loans) and retail loans (to the extent not payable in installments) after we conduct our standard loan reviews in accordance with our loan review procedures. Working capital loans may be extended on an annual basis for an aggregate term of three to five years for unsecured loans and five years for secured loans. Facilities loans, which are generally secured, may generally be extended once for a maximum of five years from the initial loan date. Retail loans may be extended for additional terms of up to 12 months for an aggregate term of ten years from the initial loan date for both unsecured loans and secured loans.

**Interest Rate Sensitivity**

The following table presents a breakdown our loans in terms of interest rate sensitivity as of December 31, 2014.

**As of December 31, 2014**

	<b>Due Within 1 Year</b>	<b>Due After 1 Year</b>	<b>Total</b>
	<b>(In billions of Won)</b>		
Fixed rate loans <sup>(1)</sup>	₩ 56,555	₩ 34,822	₩ 91,377
Variable rate loans <sup>(2)</sup>	78,645	53,857	132,502
<b>Total loans</b>	<b>₩ 135,200</b>	<b>₩ 88,679</b>	<b>₩ 223,879</b>

*Notes:*

- (1) Fixed rate loans are loans for which the interest rate is fixed for the entire term of the loan.
- (2) Variable or adjustable rate loans are for which the interest rate is not fixed for the entire term of the loan. For additional information regarding our management of interest rate risk, see Risk Management.

**Table of Contents*****Nonaccrual Loans and Past Due Accruing Loans***

Except in the case of repurchased loans, we generally recognize interest income on nonaccrual loans using the rate of interest used to discount the future cash flows of such loans for the purpose of measuring impairment loss. Generally, we discontinue accruing of interest on loans (other than repurchased loans) when payment of interest and/or principal becomes past due by 90 days. Loans (other than repurchased loans) are not reclassified as accruing until interest and principal payments are brought current.

We generally do not request borrowers to make immediate repayment of the whole outstanding principal balances and related accrued interest on loans whose interest payments are past due for one to 14 days in the case of commercial loans and one to 30 days in the case of retail loans.

Interest foregone is interest due on nonaccrual loans that has not been accrued in our books of account. In 2010, 2011, 2012, 2013 and 2014 we would have recorded gross interest income of ₩145 billion, ₩131 billion, ₩163 billion, ₩119 billion and ₩113 billion respectively, on loans accounted for on a nonaccrual basis throughout the respective years, or since origination for loans held for part of the year, had the loans been current with respect to their original contractual terms. The amount of interest income on those loans that was included in our net income in 2010, 2011, 2012, 2013 and 2014 were ₩52 billion, ₩66 billion, ₩70 billion, ₩58 billion and ₩53 billion, respectively.

The following table shows, at the dates indicated, the amount of loans that are placed on a nonaccrual basis and accruing loans which are past due one day or more. The term *accruing but past due one day* includes loans which are still accruing interest but on which principal or interest payments are contractually past due one day or more. We continue to accrue interest on loans where the total amount of loan outstanding, including accrued interest, is fully secured by cash on deposits.

	2010	2011	2012	2013	2014
	As of December 31, (In billions of Won)				
Loans accounted for on a nonaccrual basis <sup>(1)</sup>					
Corporate	₩ 1,813	₩ 1,621	₩ 1,642	₩ 1,660	₩ 1,358
Retail	155	239	416	217	233
Credit cards	155	152	215	108	152
Sub-total	2,123	2,012	2,273	1,985	1,743
Accruing loans which are contractually past due one day or more as to principal or interest					
Corporate	263	224	245	194	183
Retail	369	482	354	436	374
Credit cards	432	576	633	524	466
Sub-total	1,064	1,282	1,232	1,154	1,023
Total	₩ 3,187	₩ 3,294	₩ 3,505	₩ 3,139	₩ 2,766

*Note:*

- (1) Represents either loans that are troubled debt restructuring or loans for which payment of interest and/or principal became past due by 90 days or more (adjusting for any overlap due to loans that satisfy both prongs so as to avoid double counting).



**Table of Contents*****Troubled Debt Restructurings***

The following table presents, at the dates indicated, our loans which are troubled debt restructurings. These loans mainly consist of corporate loans that have been restructured through the process of workout and recovery proceedings. See Credit Exposures to Companies in Workout and Recovery Proceedings. These loans accrue interest at rates lower than the original contractual terms, or involve the extension of the original contractual maturity as a result of a variation of terms upon restructuring.

	2010	As of December 31, (In billions of Won)			
		2011	2012	2013	2014
Loans classified as troubled debt restructurings (excluding nonaccrual and past due loans)	₩ 193	₩ 75	₩ 173	₩ 71	₩ 173
Loans classified as troubled debt restructurings (including nonaccrual and past due loans)	₩ 1,275	₩ 1,009	₩ 868	₩ 756	₩ 635

The following table presents, for the periods indicated and with respect to the restructured loans, the amounts that would have been recorded as our interest income under the original contract terms of the restructured loans, and the amounts that were actually recorded as our interest income for such loans under the restructured contractual terms of such loans.

	2010	2011	2012	2013	2014
	(In billions of Won)				
Interest income under the original contractual terms of the restructured loans <sup>(1)</sup>	₩ 69	₩ 42	₩ 74	₩ 68	₩ 21
Interest income under the restructured contractual terms of the restructured loans <sup>(1)</sup>	₩ 31	₩ 14	₩ 20	₩ 15	₩ 12

*Note:*

(1) Includes nonaccrual and past due loans.

The following table presents a breakdown of the outstanding balance and specific allowance for loan losses as of December 31, 2010, 2011, 2012, 2013 and 2014 of corporate loans classified as troubled debt restructurings (including nonaccrual and past due loans) by the type of restructuring to which such loans are subject.

2010		2011		As of December 31, 2012		2013		2014	
Outstanding	Outstanding	Outstanding	Outstanding	Outstanding	Outstanding	Outstanding	Outstanding	Outstanding	Outstanding
Balance	Allowance	Balance	Allowance	Balance	Allowance	Balance	Allowance	Balance	Allowance
(In billions of Won)									

Corporate loans classified as troubled debt restructurings <sup>(1)</sup> :										
Workout	₩ 1,201	₩ 651	₩ 752	₩ 351	₩ 683	₩ 276	₩ 571	₩ 266	₩ 476	₩ 471
Recovery Proceedings	73	31	250	38	185	20	185	75	159	144
Others <sup>(2)</sup>	1	1	7	5						
<b>Total</b>	<b>₩ 1,275</b>	<b>₩ 683</b>	<b>₩ 1,009</b>	<b>₩ 394</b>	<b>₩ 868</b>	<b>₩ 296</b>	<b>₩ 756</b>	<b>₩ 341</b>	<b>₩ 635</b>	<b>₩ 615</b>

*Notes:*

(1) Includes nonaccrual and past due loans.

(2) Principally consists of loans subject to corporate turnaround or corporate reorganization pursuant to the Debtor Rehabilitation and Bankruptcy Act (also known as the Consolidated Insolvency Act).

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The following table presents the outstanding balance and specific allowance for loan losses as of December 31, 2010, 2011, 2012, 2013 and 2014 of retail loans (including nonaccrual and past due loans) subject to credit rehabilitation programs for retail borrowers. All such loans became modified under credit rehabilitation programs and became beneficiaries of maturity extension and interest rate reductions, while a substantially limited portion of such loans also became beneficiaries of debt forgiveness and deferral. For more information on the credit rehabilitation program, see Credit Exposures to Companies in Workout and Recovery Proceedings – Credit Rehabilitation Programs for Delinquent Consumer and Small- and Medium-sized Enterprise Borrowers.

	As of December 31,									
	2010		2011		2012		2013		2014	
	Outstanding	Allowance	Outstanding	Allowance	Outstanding	Allowance	Outstanding	Allowance	Outstanding	Allowance
	(In billions of Won)									
Retail loans subject to credit rehabilitation programs <sup>(1)</sup> :	₩ 70	₩ 58	₩ 68	₩ 54	₩ 60	₩ 46	₩ 41	₩ 30	₩ 45	₩ 27

*Note:*

(1) Includes nonaccrual and past due loans.

The following table presents, as of the dates indicated and with respect to corporate loans, the amounts of restructured loans that were considered impaired and classified as nonaccrual pursuant to our general interest accrual policy as described in Accrual Policy for Restructured Loans. The table also presents, for the periods indicated and with respect to corporate loans, the amounts of total charge-off on restructured loans and the amounts of charge-off as part of debt-to-equity conversions.

	As of and for the year ended December 31,				
	2010	2011	2012	2013	2014
	(In billions of Won)				
Impaired and nonaccrual restructured loans	₩ 1,082	₩ 934	₩ 695	₩ 685	₩ 462
Total charge-off of restructured loans	₩ 261	₩ 259	₩ 263	₩ 153	₩ 55
Charge-off as part of debt-to-equity conversion	₩ 49	₩ 46	₩ 84	₩ 29	₩ 32

***Credit Exposures to Companies in Workout and Recovery Proceedings***

Our credit exposures to restructuring are monitored and managed by our Corporate Credit Collection Department. As of December 31, 2014, 0.3% of our total loans, or ₩635 billion (of which ₩462 billion was classified as nonaccrual and ₩173 billion was classified as accruing), was under restructuring. Restructuring of our credit exposures generally takes the form of workout and recovery proceedings.

*Workout*

Under the Corporate Restructuring Promotion Act, which will remain effective until December 31, 2015, all creditors to borrowers that are financial institutions are required to participate in a creditors' committee. The Corporate Restructuring Promotion Act mandatorily applies to a wide range of financial institutions in Korea, which include commercial banks, insurance companies, asset management companies, securities companies, merchant banks, the Korea Deposit Insurance Corporation and the Korea Asset Management Corporation. Under this act, the approval of financial institution creditors holding not less than 75% of the total debt outstanding of a borrower is required for such borrower's restructuring plan, including debt restructuring and provision of additional funds, which plan becomes binding on all the financial institution creditors of the borrower, provided that any financial institution creditor that disagrees with the final restructuring plan approved by the creditors' committee has the right to request the creditors' committee to purchase its claims at a mutually agreed price. If the creditors' committee and the dissenting financial institution creditor fail to come to an agreement, a mediation committee consisting of seven experts is set up to resolve the matter. There is a risk that these procedures may require us to participate in a plan we do not agree with or may require us to sell our claims at prices that we do not believe

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are adequate. With respect to any workout for which the lead creditor bank called for a meeting of the creditors committee while the old Corporate Restructuring Promotion Act was still effective, the procedures applicable to such creditors committee and the related workout remain subject to the old Corporate Restructuring Promotion Act until the suspension or conclusion of such workout, provided that such workout became subject to the procedures under the reinstated Corporate Restructuring Promotion Act as of its effective date, as opposed to the old Corporate Restructuring Promotion Act, even if such workout began while the old law was in effect. Under the reinstated Corporate Restructuring Promotion Act, if any of our borrowers becomes subject to corporate restructuring procedures, we may be forced to (i) restructure our credits pursuant to restructuring plans approved by other creditor financial institutions holding 75% or more of the total outstanding debt (and 75% or more of the total outstanding secured debt, if the restructuring plan includes the restructuring of existing secured debt) of the borrower or (ii) dispose of our credits to other creditors on unfavorable terms.

The total loan amount currently undergoing workout as of December 31, 2014 was ₩476 billion.

*Recovery Proceedings*

Under the Debtor Rehabilitation and Bankruptcy Act, which took effect on April 1, 2006, court receiverships have been replaced with recovery proceedings. In a recovery proceeding, unlike court receivership proceedings where the management of the debtor company was vested in a court appointed receiver, the existing chief executive officer of the debtor company may continue to manage the debtor company, provided, that (i) neither fraudulent conveyance nor concealment of assets existed, (ii) the financial failure of the debtor company was not due to gross negligence of such chief executive officer, and (iii) no creditors meeting was convened to request, based on reasonable cause, a court-appointed receiver to replace such chief executive officer. Recovery proceeding may be commenced by any insolvent debtor. Furthermore, in an effort to meet the global standards, international bankruptcy procedures have been introduced in Korea under which a receiver of a foreign bankruptcy proceeding may, upon receiving Korean court approval of the ongoing foreign bankruptcy proceeding, apply for or participate in a Korean bankruptcy proceeding. Similarly, a receiver in a domestic recovery proceeding or a bankruptcy trustee is allowed to perform its duties in a foreign country where an asset of the debtor is located to the extent the applicable foreign law permits.

Any composition, corporate reorganization, bankruptcy and rehabilitation proceedings for individual debtors pending as of April 1, 2006, the effective date of the Debtor Rehabilitation and Bankruptcy Act, continue to proceed in accordance with the respective applicable laws.

As of December 31, 2014, the total loan amount subject to recovery proceedings was ₩159 billion. No loan amount was subject to court receivership or composition proceedings.

Loans in the process of workout and recovery proceedings are reported as nonaccrual loans on our statements of financial position as described in Nonaccrual Loans and Past Due Accruing Loans above since generally, they are past due by more than 90 days and interest does not accrue on such loans. Restructured loans that meet the definition of a troubled debt restructuring are reported as troubled debt restructurings as described above in Troubled Debt Restructurings. Such restructured loans are reported as either loans or securities on our statements of financial position depending on the type of instrument we receive as a result of the restructuring.

*Credit Rehabilitation Programs for Delinquent Consumer and Small- and Medium-sized Enterprise Borrowers*

In light of the gradual increase in delinquencies in credit card and other consumer credit, the Korean government has implemented a number of measures intended to support the rehabilitation of the credit of delinquent consumer borrowers. These measures may affect the amount and timing of our collections and recoveries on our delinquent

consumer credits.

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Upon application to the Credit Counseling and Recovery Service and approval of a majority of unsecured and secured creditor financial institutions, a qualified credit delinquent person with outstanding debts to financial institutions in an aggregate amount not exceeding ₩1.5 billion may participate in an individual work-out program designed to restructure such person's debt and rehabilitate such person's credit.

Under the Debtor Rehabilitation and Bankruptcy Act, a qualified individual debtor with outstanding debts in an aggregate amount not exceeding threshold amounts of ₩500 million of unsecured debt and/or ₩1 billion of secured debt may restructure his or her debts through a court-supervised debt restructuring that is binding on creditors.

Kookmin Happy Fund, which has been established by the Financial Services Commission, purchases defaulted loans from creditors or provide credit guarantees to enable refinancing at lower rates in order to assist retail borrowers with low credit scores. More specifically, Kookmin Happy Fund provides credit guarantees to borrowers who (i) have credit scores between category 6 and 10 (which requirement will be waived for individuals who are basic living welfare recipients or have an annual income not exceeding ₩30 million); (ii) earn an annual income not exceeding ₩40 million (or, in the case of borrowers who are self-employed or have two or more dependent family members, earn an annual income not exceeding ₩45 million); (iii) have made timely repayments for at least six months in an aggregate repayment amount exceeding ₩10 million or for at least three months in an aggregate repayment amount not exceeding ₩10 million. In 2014, we sold loans in an aggregate amount of ₩0.5 billion to Kookmin Happy Fund.

Under the guidelines of the Financial Supervisory Service, Korean banks, including us, operate a fast track program to provide liquidity assistance to small- and medium-sized enterprises on an expedited basis. Under the fast track program we established, which is effective until the end of 2015, we provided liquidity assistance to small- and medium-sized enterprise borrowers applying for such assistance, in the form of new short-term loans or maturity extensions or interest rate adjustments with respect to existing loans, after expedited credit review and approval by us.

Under the guidelines of the Financial Services Commission, Korean banks, including us, also operate a pre-workout program, including a credit counseling and recovery service, for retail borrowers with short-term outstanding debt. Our pre-workout program is generally available to retail borrowers meeting all of the following requirements: (i) unsecured borrowings from at least two financial institutions not exceeding ₩500 million in the aggregate; (ii) payment default of more than 30 days but less than 90 days; (iii) all borrowings newly made within six months prior to the application for the pre-workout program not to exceed 30% of the applicant's total outstanding borrowings; (iv) the annual aggregate amount of principal and interest payment obligations being 30% or more of the borrower's annual income; (v) assets in possession of less than ₩1 billion, and in the case of real estate, calculated based on the official land price announced by the Ministry of Land, Infrastructure and Transport; and (vi) a person deemed by the pre-workout committee to be impaired in his or her ability to repay without a pre-workout arrangement due to layoff, unemployment, business closure, disaster or earnings loss. Retail borrowers who fail any of these requirements, have previously participated in the pre-workout program or have lost eligibility in the course of participating in a previous pre-workout program are ineligible to participate in the pre-workout program.

Once a borrower is deemed to be eligible to participate in the pre-workout program, we promptly sell the collateral underlying such borrower's secured loans to mitigate our losses, and we may restructure such borrower's unsecured loans (regardless of their type) as follows:

*Extension of maturity:* Based on considerations of the type of loan, the total loan amount, the repayment amount and the probability of repayment, the maturity of the loan may be extended by up to 10 years.

*Interest rate adjustment:* The interest rate of the loan may be adjusted to 70% of the original interest rate or 5% per annum, whichever is higher; *provided that* if the original interest rate is less than 5% per



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annum, no adjustment applies. The adjusted interest rate applies to the principal amount following any adjustment thereto as part of the pre-workout program, and no interest accrues on the interest already accrued or fees payable.

*Debt forgiveness:* Debt forgiveness under the pre-workout program is limited to (i) the default interest accrued prior to the application for the pre-workout program and (ii) the regular and default interest accrued following such application but before the approval of the program.

*Deferral:* If the foregoing three measures are deemed to be insufficient in terms of providing meaningful assistance to a qualifying borrower due to layoff, unemployment, business closure, disaster or earnings loss, loan repayment may be deferred for a maximum of one year, *provided that* the pre-workout committee may extend such deferral period upon the borrower's application which can be made at a one-month interval. The deferral period is not counted toward the repayment period, and interest accrues at 3% per annum during the deferral period.

In 2014, the aggregate amount of our retail credit (including credit card receivables) provided by Shinhan Bank which became subject to the pre-working program was ₩45 billion. We believe that our participation in such pre-workout program has not had a material impact on the overall asset quality of our retail loans and credit card portfolio or on our results of operations and financial condition to-date.

***Loan Modification Programs for Loans under Restructuring***

We generally offer the following types of concessions in relation to restructured loans: reduction of interest rate, forgiveness of overdue interest, extension of the term for repayment of principal, conversion of debt into equity or the combination of the foregoing. The nature and degree of such concessions vary depending on, among other things, the creditworthiness of the borrower, the size of loans being restructured, the existing terms of the loans and other factors deemed relevant by the relevant creditors' committee. We generally do not restructure an existing loan into multiple new loans (for example, an A Note/B Note structure).

The following table presents a breakdown of the gross amount of loans under restructuring as of December 31, 2010, 2011, 2012, 2013 and 2014 by our loan modification programs, as further categorized according to the loan category and performing versus non-performing status.

Modification Programs	2010		Total
	Non-Performing	Performing	
	(In billions of Won)		
Extension of due date for principal and interest	₩ 20	₩ 177	₩ 197
Reduction of interest rate	155	241	396
Forgiveness of principal			
Equity conversion	15	10	25
Additional lending <sup>(1)</sup>	3	233	236
Others <sup>(2)</sup>	51	370	421
<b>Total</b>	<b>₩ 244</b>	<b>₩ 1,031</b>	<b>₩ 1,275</b>

Modification Programs	2011		Total
	Non-Performing	Performing	
	(In billions of Won)		
Extension of due date for principal and interest	₩ 43	₩ 340	₩ 383
Reduction of interest rate	40	213	253
Forgiveness of principal		1	1
Equity conversion		46	46
Additional lending <sup>(1)</sup>	1	97	98
Others <sup>(2)</sup>	63	165	228
<b>Total</b>	<b>₩ 147</b>	<b>₩ 862</b>	<b>₩ 1,009</b>

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Modification Programs	2012		Total
	Non-Performing	Performing	
	(In billions of Won)		
Extension of due date for principal and interest	₩ 4	₩ 142	₩ 146
Reduction of interest rate	90	322	412
Forgiveness of principal			
Equity conversion	3		3
Additional lending <sup>(1)</sup>		179	179
Others <sup>(2)</sup>	51	77	128
<b>Total</b>	<b>₩ 148</b>	<b>₩ 720</b>	<b>₩ 868</b>

Modification Programs	2013		Total
	Non-Performing	Performing	
	(In billions of Won)		
Extension of due date for principal and interest	₩ 2	₩ 81	₩ 83
Reduction of interest rate	54	283	337
Forgiveness of principal			
Equity conversion			
Additional lending <sup>(1)</sup>	27	169	196
Others <sup>(2)</sup>	37	103	140
<b>Total</b>	<b>₩ 120</b>	<b>₩ 636</b>	<b>₩ 756</b>

Modification Programs	2014		Total
	Non-Performing	Performing	
	(In billions of Won)		
Extension of due date for principal and interest	₩ 4	₩ 3	₩ 7
Reduction of interest rate	52	260	312
Forgiveness of principal	10		10
Equity conversion			
Additional lending <sup>(1)</sup>	1	198	199
Others <sup>(2)</sup>	61	46	107
<b>Total</b>	<b>₩ 128</b>	<b>₩ 507</b>	<b>₩ 635</b>

Notes:

- (1) Represents additional loans provided to the borrower at favorable terms as part of the restructuring package, which may include extension of the due date or reduction of interest rate, among others.
- (2) Principally consists of restructured loans whose restructuring terms were not determined as of the end of the period indicated. A loan is deemed to be subject to restructuring upon the commencement of the recovery proceedings or when the relevant creditors' committee or our credit officer determines that the borrower will be subject to workout, and in many cases the restructuring terms for such loans are not determined at the time such loans are deemed to be subject to restructuring.

*Debt-to-equity Conversion*

We distinguish between loans that we consider to be collectible under modified terms and loans that we consider to be uncollectible regardless of any modification of terms. With respect to loans in the latter category, we convert a portion of such loans into equity securities following negotiation with the borrowers and charge off the remainder of such loans as further described below. The equity securities so converted are recorded at fair value, based on the market value of such securities if available or the appraisal value of such securities by an outside appraiser if a market value is unavailable. In 2014, our loans restructured into equity securities amounted to ₩59 billion, of which ₩32 billion was subsequently treated as charge-off and ₩27 billion was treated as the new cost basis of the equity securities.

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Debt-to-equity conversion generally has two primary benefits. One, the debt-to-equity conversion reduces the amount of loans and related interest expenses of the borrower, resulting in lesser debt burden and greater liquidity for the borrower, a greater likelihood of its exit from restructuring and the repayment of its obligations to us. Two, in the case of a successful turnaround of the borrower, we are entitled to the upside gains from the increase in the value of the equity securities so converted. Notwithstanding these benefits, however, the resulting impact from the debt-to-equity conversion on our interest income is generally not material as the loans being converted as part of restructuring are generally deemed to be uncollectible regardless any modification of terms. As for the impact on our asset classification, we generally apply the same asset classification standards to both non-restructured and restructured loans. As for restructured loans, we also consider additional factors such as the borrower's adherence to its business plans and execution of the self-help measures, among others, to the extent applicable. In consideration of such criteria, we generally classify loans subject to workout as precautionary. For a general discussion of our loan classifications, see *Supervision and Regulation* *Principal Regulations Applicable to Financial Holding Companies* *Capital Adequacy*.

*Evaluation of Loan Modification Programs*

We currently do not conduct a systematic or quantitative evaluation of the success of any particular concession by type, whether historically, relative to each other or relative to other financial institutions in Korea, although we do monitor on an individual basis the compliance by the borrower with the modified terms of the restructured loans. This is principally due to the following reasons.

One, in the case of large corporations subject to or about to be subject to restructuring, which represents the most significant restructuring cases in Korea, the restructuring process is generally not driven by us, but by a creditors committee involving several large creditor financial institutions, and in the case of very large corporations or corporations that are members of large business conglomerates, the process frequently involves the guidance of the Government in light of the potential ripple effects of the restructuring on the general economy. Hence, it is difficult for us to collect data that would help us to evaluate the success of a particular concession based on the credit profile of the borrower and the type of concessions offered.

Two, the unavailability of systematic analysis notwithstanding, our general sense is that the restructuring cases in Korea have, to a large part, been successful as measured in terms of the ability of the borrowers to exit restructuring programs relatively quickly and further that the failed cases have not been particularly material. As a result, to date, we have not found it particularly necessary or helpful to expend the time and resources required to conduct a systematic analysis for purposes of evaluating the success of concessions by the type of a particular concession offered.

We do, however, measure the success of concessions in limited ways, that is, principally in terms of how well the borrower complies with the terms and conditions of the restructuring plan as agreed between the borrower and its creditor institutions. A restructuring plan typically includes a business plan and self-help measures to be undertaken by the borrower. We monitor the borrower's compliance with the restructuring plan on a periodic basis (namely, annual, semiannual or quarterly in accordance with the terms of the restructuring plan) and evaluate the success thereof principally in terms of three attributes: (i) the progress in the execution of the business plan, (ii) the progress in the execution of the self-help measures and (iii) other qualitative factors such as major developments in the general economy, the regulatory environment, the competitive landscape, the quality of senior management and personnel, and transparency in management. We also closely monitor the cash inflows and outflows of the borrower, and the creditors' committee typically has the right to participate in decision-making related to major spending and borrowings by the borrower.

*Accrual Policy for Restructured Loans*

For purposes of our accrual policy, we classify restructured loans principally into (i) loans subject to workout pursuant to the Corporate Restructuring Promotion Act and (ii) loans subject to recovery proceedings

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pursuant to the Debtor Rehabilitation and Bankruptcy Act, which is the comprehensive bankruptcy-related law in Korea. See Credit Exposures to Companies in Workout and Recovery Proceedings. As for loans subject to workout, our general policy is to discontinue accruing interest on a loan when payment of principal and/or interest thereon becomes past due by 90 days or more, as described above in Nonaccrual Loans and Past Due Accruing Loans. Interest is recognized on these loans on a cash basis (i.e., when collected) from the date such loan is reclassified as non-accruing, and such loans are not reclassified as accruing until the overdue principal and/or interest amounts are paid in full. This general policy also applies to loans subject to workout even if such loans are restructured loans. In the case of loans subject to recovery proceedings, we discontinue accruing interest immediately upon the borrowers becoming subject to recovery proceedings (even if such loans are not yet delinquent) in light of the heightened uncertainty regarding the borrower's ability to repay, interest on such loans are recognized on a cash basis and such loans are not reclassified as accruing until the borrower exits recovery proceedings. Accordingly, under our accrual policy, the number of payments made on a nonaccrual restructured loan is not a relevant factor in determining whether to reinstate such loan to the accrual status.

*Determination of Performance of Restructured Loans*

In determining whether a borrower has satisfactorily performed its obligations under the existing loan terms, we principally review the payment history of the borrower, namely whether the borrower has been delinquent by one day or more pursuant to our general interest accrual policy. In determining whether a borrower has shown the capacity to continue to perform under the restructured terms, we primarily rely upon the assessment of our credit officers (or the creditors' committee in the case of large corporate borrowers with significant outstanding loans) of the likelihood of the borrower's ability to repay under the restructured terms, which assessment takes into account the size of the loans in question, the credit profile of the borrower, the original terms of the loans and other factors deemed relevant by the relevant credit officers. Depending on various factors such as the size of the loans in question and the credit profile of the borrower, we or the relevant creditors' committee, as the case may be, sometimes engage an outside advisory firm to perform further due diligence in order to supplement the aforementioned assessment. In certain cases, the borrowers also submit self-help proposals to facilitate obtaining the approval for restructuring, which measures are then also taken into consideration by our credit officers or the relevant creditors' committees, as the case may be, in determining their future capacity to continue to perform under the restructured terms.

*Charge-off of Restructured Loans*

As for loans that we consider to be collectible under modified terms (for example, by extending the due date for the payment of principal and/or interest or reducing the interest rate below the applicable interest rate to a rate below the prevailing market rate, or a combination of the foregoing), we generally restructure such loans under the modified terms and do not charge off any portion of such loans.

As for loans that we consider to be uncollectible regardless of any modification of terms, we negotiate with the borrower to have a portion of such loans converted into equity securities (usually common stock) of the borrower in consideration, among others, of (i) the degree to which such conversion will alleviate the debt burdens and liquidity concerns of the borrower, (ii) our potential upside from the gain in the value of the equity securities compared to the likelihood of collection if the loans were not converted into equity securities, and (iii) the borrower's concerns regarding its shareholding structure subsequent to such conversion. We then charge off the remainder of the loans not converted into equity securities. The value of the equity securities so converted is recorded at fair value, based on the market value of such securities if available or the appraisal value of such securities by an outside appraiser if a market value is unavailable.

Since we generally do not accrue interest on loans subject to recovery proceedings while we generally accrue interest on loans subject to workout unless past due by 90 days or more, charge-off is not a relevant factor we consider when determining the accrual status of a particular restructured loan.

We continue to accrue interest on restructured loans if we conclude that repayment of interest and principal contractually due on the entire debt is reasonably assured. Such conclusion is reached only after we have



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carefully reviewed the borrower's ability to repay based on an assessment, among others, of various factors such as the size of the loans in question and the credit quality of the borrower by our credit officer or the relevant creditors committee as supplemented by the due diligence by outside advisory firms, as the case may be.

### ***Potential Problem Loans***

In 2012, in order to enable a more systematic and real-time monitoring of loans with a significant potential of non-repayment, we have upgraded our early warning system. This system enables our management to determine potential problem loans to include all loans which have caused our management to have serious doubt as to the ability of the borrowers to comply with their respective loan repayment terms.

We classify potential problem loans as loans that are designated as early warning loans and reported to the Financial Supervisory Service. The early warning loans designation applies to borrowers that have been (i) identified by our early warning system as exhibiting signs of credit risk based on the relevant borrower's financial data, credit information and/or transactions with banks and, following such identification and (ii) designated by our loan officers as potential problem loans on their evaluation of known information about such borrowers' possible credit problems. Such loans are required to be reported on a quarterly basis to the Financial Supervisory Service. If a borrower's loans are designated as early warning loans pursuant to the process described above and included in our quarterly report to the Financial Supervisory Service, we consider this to be an indication of serious doubt as to such borrower's ability to comply with repayment terms in the near future. As of December 31, 2014, we had ₩1,503 billion of potential problem loans.

### ***Other Problematic Interest-Earning Assets***

In the past, we received certain other interest-earning assets in connection with troubled debt restructuring that, if they were loans, would be required to be disclosed as part of the problem, past due or restructuring or potential problem loan disclosures provided above. However, as of December 31, 2010, 2011, 2012, 2013 and 2014, we had no such assets.

### ***Provisioning Policy***

We conduct periodic and systematic detailed reviews of our loan portfolios to identify credit risks and to establish the overall allowance for loan losses. Our management believes the allowance for loan losses reflects the best estimate of the probable loan losses incurred as of the date of each statement of financial position.

We first assess whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for financial assets that are not individually significant. If we determine that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, we include the asset in a group of financial assets with similar credit risk characteristics and collectively assess them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If there is objective evidence that a financial asset, such as a loan or receivable, has suffered impairment loss, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flow (excluding anticipated future credit losses) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition).

If the financial asset in question is a loan or receivable with a floating rate, the discount rate used to evaluate impairment loss is the current effective interest rate defined in the relevant transaction agreement. The present value of estimated future cash flows of secured financial assets is calculated by including cash flows from collateral after deducting costs to acquire and sell the collateral, regardless of the probability of realization of such collateral.

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In assessing collective impairment, we rate and classify financial assets based on credit risk assessment or credit rating assessment process that takes into account asset type, industry, regional location, collateral type, delinquency and other relevant factors.

Future cash flow of financial assets applicable to collective impairment assessment is estimated by using statistical modeling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, as adjusted for management's judgment as to whether current economic and credit conditions are such that the impairment losses are likely to be greater or less than suggested by historical modeling. When adjusting future cash flow based on historical modeling, we ensure that such adjustments are in line with changes and trends of observable data. Methodologies and assumptions used to estimate future cash flow are evaluated on a regular basis in order to reduce any discrepancy between impairment loss estimation and actual loss. See Item 5.A. Operating Results Critical Accounting Policies Impairment of Financial Assets Allowance for Loan Losses.

*Corporate Loans*

We review corporate loans annually for potential impairment through a formal credit review. In addition, our loan officers consider the credits for impairment throughout the year if there is an indication that an impairment event has occurred.

Under IFRS, a loan is impaired if objective evidence indicates that a loss event has occurred after the initial recognition of the asset, and if the loss event had a negative effect on the estimated future cash flows of that asset and can be estimated reliably. We consider, among others, the following loans to be impaired:

loans whose principal or interest amount is more than 90 days past due;

loans that by reason of non-performance becomes subject to write-off, charge-off, debt restructuring (including recovery proceedings and workout) or bankruptcy;

loans to customers whose credit record shows past instances of delinquency, enforcement of guarantee or subrogation; and

loans to customers who become finally insolvent by an order to suspend settlement of personal checks, corporate checks or promissory note.

Loan loss allowances for corporate loans are established based on whether a particular loan is impaired. Corporate loans with relatively small balances are evaluated collectively for impairment as they are managed collectively.

*Loans individually identified for review and considered impaired*

Consistent with the internal credit risk monitoring policies, we evaluate impaired loans with relatively large balances (typically more than ₩3 billion) individually for impairment. Loan loss allowances for these loans are generally established by discounting the estimated future cash flows (both principal and interest) we expect to receive using the loan's effective interest rate. We consider the likelihood of all possible outcomes in determining our best estimate of expected future cash flows. Management consults closely with individual loan officers and reviews the cash flow

assumptions used to ensure these estimates are valid.

We establish allowances for impaired corporate loans when the discounted cash flow of the loan is lower than its carrying amount. The allowance is equal to the difference between the discounted cash flow amount of the loan and its carrying amount.

We may also measure impairment by reference to the loan's observable market price; however this information is not commonly available in Korea.

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### *Loans collectively evaluated for impairment*

We also establish allowances for impaired corporate loans with relatively small balances (typically ₩3 billion or less). We manage these loans on a portfolio basis and therefore collectively evaluate them for impairment since it is impractical to analyze each such loan on an individual basis. The allowance for such loans is determined based on loss factors taking into consideration past performance of the portfolio, previous loan loss history and charge-off information.

We identify loss factors based on the discounted cash flow ( DCF ) model using a statistical tool with look-back periods longer than a year. For impaired corporate loans whose amounts are relatively small, we use the collective DCF model, under which cash flow projections for the relevant loans are not individually computed for each borrower, but are collectively computed for a group of loans sharing similar characteristics (for example, retail versus corporate, secured versus unsecured, and so forth), except that, when we discount the projected cash flow at the present value, we apply the interest rate effective prior to impairment specific to each borrower.

### *Loans not specifically identified as impaired*

We establish allowances collectively for non-impaired corporate loans to reflect losses incurred within the portfolio which have not yet been specifically identified as impaired. We use the probability of default / loss-given default method, also known as the Advanced Internal Rating-Based approach under Basel II, to calculate the historical loss rate on migration analysis based on measurable long-term risk factors such as probability of default from risk grading and loss given default based on the Basel II framework.

As for the probability of default-based loan grouping, corporate loans are grouped into different risk classes based on the credit rating assigned by the relevant credit evaluation model, and retail loans are grouped into different risk classes based on the type of the loan, maturity structure and the duration of delinquency.

As for the loss given default-based loan grouping, secured loans are grouped into different risk classes based on the type of collateral, the location of the collateral and the loan-to-value ratio to which they are subject, and unsecured loans are grouped into different risk classes based on the type of the loan.

### *Retail Loans*

We consider the following retail loans to be impaired for an individual assessment of impairment:

loans whose principal or interest amount is more than 90 days past due;

loans that by reason of non-performance becomes subject to write-off, charge-off, debt restructuring (including recovery proceedings and workout) or bankruptcy;

loans to customers whose credit record shows past instances of delinquency, enforcement of guarantee or subrogation; and

loans to customers who become finally insolvent by an order to suspend settlement of personal checks, corporate checks or promissory note.

The provisioning policy for retail loans is similar to that for corporate loans, except that different groupings are used for retail loans for purposes of determining probability of default and loss-given default in that all retail loans, regardless of their size, are collectively (rather than individually) assessed due to difficulties in obtaining personal information, such as personal income and assets.

For loan losses for retail loans, we also establish allowances based on loss factors taking into consideration the historical performance of the portfolio, previous loan loss history and charge-off information over a nine-year look-back period for loans secured by real estate and a four-year look-back period for unsecured loans and other secured loans.

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We further adjust the loss factors based on factors that may impact loss recognition which have not been adequately captured by our historical analysis. These factors include:

changes in economic and business conditions such as levels of unemployment and housing price;

changes in the nature and volume of the portfolio, including any concentration of credits; and

external factors such as regulatory or government requirements.

### *Credit Cards*

We establish an allowance for the credit card portfolio using a roll-rate model. A roll-rate model is a statistical tool used to monitor the progression of loans based on aging of the balance and established loss rates. The actual loss rates derived from this model are used to project the percentage of losses within each aging category based on performance over a five-year look-back period.

The expected percentage of loss reflects estimates of both the default probability within each loan aging category and the magnitude of loss. Generally, loans that are six months or more past due are charged off. We consider adjusting our loan loss rate for the magnitude of loss after accounting for the historical recovery of charged off credits when establishing the allowance.

We segment our credit card portfolio into several product types and perform separate roll-rate analysis for such product types to reflect the different risks and characteristics of each such product type.

We further consider adjusting the results from the roll-rate analysis based on factors that may impact loss recognition which have not been adequately captured by our historical analysis. These factors include:

delinquency levels of cardholders;

government policies toward the credit card industry; and

key retail performance indicators (such as ratios of household debt to disposable income and household liabilities to financial assets).

The actual amount of incurred loan losses may vary from the estimate of incurred losses due to changes in economic conditions or industry or geographic concentrations. We also monitor differences between estimated and actual incurred loan losses through procedures including detailed periodic assessments by senior management of both individual loans and credit portfolios and the models used to estimate incurred loan losses in those portfolios.

We determine whether credit card loans are impaired using criteria similar to those used for corporate loans, except that upon the closure of business by merchants using our credit card services, the related credit card loans are deemed impaired.

We consider a credit card or card loan to be delinquent if payment on such account is not received when first due and the amount outstanding is greater than ₩10,000. Our general policy is to be proactive in its collection procedures. We believe that card accounts which are in early stages of delinquency are easier to collect than those accounts which have been delinquent for a longer period of time and, therefore, we emphasize collections at an early stage of delinquency although we increase the level of collection efforts as the delinquency period increases with respect to the relevant account. Efforts to collect from cardholders whose account balances are up to 30 days past due are generally made by our credit support centers at Shinhan Card. Our credit support centers classify delinquent customers based upon three criteria: the expected level of difficulty in collection, the nature of the customer and the customer's contribution to Shinhan Card's profitability. By implementing collection activities tailored to each such category of customers, we seek to maximize efficiency in our collection efforts.



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For card accounts with balances that are more than 30 days past due, we generally assign collection to our collection branches. During the first two months of their appointment, these collection branches rely on postal or telephone notice and take measures to locate and provisionally attach accounts receivables or other properties of the delinquent cardholders. After the initial two months period, the collection branches commence compulsory execution procedures against the delinquent cardholders' accounts receivables or other properties to secure the amount of outstanding balances. During the entire period managed by branches, we offer restructured card loan and reduction programs. For card accounts that are charged off, we outsource collection to external collection centers such as Shinhan Credit Information, which is our subsidiary, and Mirae Credit Information Services Corp.

**Loan Aging Schedule**

The following table shows our loan aging schedule (excluding accrued interest) for all loans as of the dates indicated.

As of December 31,	Current		Past Due Up to 3 Months		Past Due 3-6 Months		Past Due More Than 6 Months		Total Amount
	Amount	%	Amount	%	Amount	%	Amount	%	
(In billions of Won, except percentages)									
2010	181,659	98.59	1,163	0.63	635	0.34	792	0.43	184,249
2011	192,120	98.50	1,519	0.77	597	0.31	819	0.42	195,055
2012	199,658	98.39	1,563	0.77	579	0.29	1,116	0.55	202,916
2013	205,282	98.70	1,508	0.73	420	0.20	777	0.37	207,987
2014	221,273	98.84	1,320	0.59	706	0.32	580	0.26	223,879

**Non-Performing Loans**

Non-performing loans are defined as loans past due by more than 90 days. The following table shows, as of the dates indicated, the amount of the total non-performing loan portfolio and as a percentage of our total loans.

	As of December 31,				
	2010	2011	2012	2013	2014
(In billions of Won, except percentages)					
Total non-performing loans	₩ 1,427	₩ 1,416	₩ 1,695	₩ 1,197	₩ 1,286
As a percentage of total loans	0.77%	0.73%	0.84%	0.58%	0.57%

**Table of Contents****Analysis of Non-Performing Loans**

The following table sets forth, for the periods indicated, the total non-performing loans by the borrower type.

	2010		2011		As of December 31, 2012		2013					
	Non-Performing Loans <sup>(1)</sup>	Ratio of Non-Performing Loans	Total Loans	Non-Performing Loans <sup>(1)</sup>	Ratio of Non-Performing Loans	Total Loans	Non-Performing Loans <sup>(1)</sup>	Ratio of Non-Performing Loans	Total Loans	Non-Performing Loans <sup>(1)</sup>	Ratio of Non-Performing Loans	Total Loans
	(In billions of Won, except percentages)											
35	₩ 816	0.85%	₩ 98,598	₩ 739	0.75%	₩ 101,162	₩ 769	0.76%	₩ 102,823	₩ 529	0.51%	₩ 112,145
71	8	0.29	4,930	8	0.16	3,107	9	0.29	2,525			2,135
57			2,557			4,557			6,103			4,684
55	10	0.64	1,639	5	0.31	1,699	8	0.47	1,721	11	0.64	1,844
28	834	0.82	107,724	752	0.70	110,525	786	0.71	113,172	540	0.48	120,808
73	30	0.07	44,399	55	0.12	46,130	60	0.13	46,908	41	0.09	50,652
01	102	0.41	25,052	164	0.65	28,407	315	1.11	30,242	174	0.58	34,278
74	132	0.20	69,451	219	0.31	74,537	375	0.50	77,150	215	0.28	84,930
47	461	2.61	17,880	445	2.49	17,854	534	2.99	17,665	442	2.50	18,141
49	₩ 1,427	0.77%	₩ 195,055	₩ 1,416	0.73%	₩ 202,916	₩ 1,695	0.84%	₩ 207,987	₩ 1,197	0.58%	₩ 223,879

Note:

(1)

Includes unsecured retail loans and credit card loans past due by more than six months. The number of days past due of restructured credit card loans is calculated from the first date of non-payment regardless of subsequent modification of terms.

**Table of Contents****Non-Performing Loans by Industry**

The following table sets forth a breakdown of our non-performing corporate loans by industry as of December 31, 2014.

<b>Industry</b>	<b>Aggregate Non-Performing Corporate Loan Balance (In billions of Won)</b>	<b>Percentage of Total Non-Performing Corporate Loan Balance (Percentages)</b>
Real estate, leasing and service	₩ 180	31.80%
Construction	44	7.77
Manufacturing	158	27.92
Retail and wholesale	22	3.89
Transportation, storage and communication	19	3.36
Hotel and leisure	23	4.06
Finance and insurance	12	2.12
Other service <sup>(1)</sup>	42	7.42
Other <sup>(2)</sup>	66	11.66
<b>Total</b>	<b>₩ 566</b>	<b>100.00%</b>

*Notes:*

(1) Includes other service industries such as publication, media and education.

(2) Includes other industries such as agriculture, forestry, mining, electricity and gas.

**Top 20 Non-Performing Loans**

As of December 31, 2014, our 20 largest non-performing loans accounted for 25.58% of our total non-performing loan portfolio. The following table shows, at the date indicated, certain information regarding our 20 largest non-performing loans.

<b>As of December 31, 2014</b>		
<b>Industry</b>	<b>Gross Principal Outstanding (In billions of Won)</b>	<b>Allowance for Loan Losses</b>

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1	Borrower A	Real estate, leasing and service	₩	90	₩	
2	Borrower B	Manufacturing		29		3
3	Borrower C	Manufacturing		22		
4	Borrower D	Construction		20		1
5	Borrower E	Construction		18		6
6	Borrower F	Manufacturing		18		
7	Borrower G	Other service		17		17
8	Borrower H	Manufacturing		13		
9	Borrower I	Other service		12		
10	Borrower J	Other service		10		7
11	Borrower K	Finance and Insurance		10		2
12	Borrower L	Other Service		9		
13	Borrower M	Manufacturing		9		9
14	Borrower N	Real estate, leasing and service		9		
15	Borrower O	Real estate, leasing and service		9		
16	Borrower P	Real estate, leasing and service		8		
17	Borrower Q	Other service		8		
18	Borrower R	Construction		6		
19	Borrower S	Other service		6		
20	Borrower T	Transportation, storage and communication		6		
			₩	329	₩	45

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***Non-Performing Loan Strategy***

One of our primary objectives is to prevent our loans from becoming non-performing. Through our corporate credit rating system, which is designed to prevent our loan officers from extending new loans to borrowers with high credit risks based on the borrower's credit rating, we seek to reduce credit risk related to future non-performing loans. Our early warning system is designed to bring any sudden increase in a borrower's credit risk to the attention of our loan officers, who then closely monitor such loans.

If a loan becomes non-performing notwithstanding such preventive mechanism, an officer at the branch level responsible for monitoring non-performing loans will commence due diligence on the borrower's assets, send a notice demanding payment or a notice that we will take or prepare for legal action.

At the same time, we also initiate our non-performing loan management process, which includes:

identifying loans subject to a proposed sale by assessing the estimated losses from such sale based on the estimated recovery value of collateral, if any, for such non-performing loans;

identifying loans subject to charge-off based on the estimated recovery value of collateral, if any, for such non-performing loans and the estimated rate of recovery of unsecured loans; and

to a limited extent, identifying commercial loans subject to normalization efforts based on the cash-flow situation of the borrower.

Once the details of a non-performing loan are identified, we pursue early solutions for recovery. Actual recovery efforts for non-performing loans are handled by the relevant department, depending on the nature of such loans and the borrower, among others. The officers or agents of the responsible departments and units use a variety of methods to resolve non-performing loans, including:

making phone calls and paying visits to the borrower to request payment;

continuing to assess and evaluate assets of our borrowers; and

if necessary, initiating legal action such as foreclosures, attachment and litigation.

In order to promote speedy recovery on loans subject to foreclosures and litigation, the branch responsible for handling these loans may transfer them to the relevant unit at headquarters.

Our policy is to commence legal action within one month after default on promissory notes and four months after delinquency of payment on other types of loans. For loans to insolvent or bankrupt borrowers or when we conclude that it is not possible to recover through normal procedures, we take prompt legal actions regardless of the grace period.

In addition to making efforts to collect on these non-performing loans, we take other measures to reduce the level of our non-performing loans, including:

selling non-performing loans to third parties including the Korea Asset Management Corporation;

entering into asset-backed securitization transactions with respect to non-performing loans;

managing retail loans that are three months or more past due through Shinhan Credit Information under an agency agreement; and

using third-party collection agencies including credit information companies such as Solomon Credit Information.

In 2014, we sold non-performing loans in the amount of ₩27 billion to third parties and transferred ₩13 billion to the Baro Investment and Securities. See Item 3.D. Risk Factors Other Risks Relating to Us The Korean government may encourage targeted lending to and investment in certain sectors in furtherance of policy initiatives, and we may take this factor into account. These loans met the criteria of true sale and were derecognized accordingly.

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The following table presents a roll-forward of our non-performing loans in 2014.

	(In billions of Won)	
Non-performing loans as of December 31, 2013	₩	1,197
Additional non-performing loans due to delinquency		596
Loans sold		(27)
Loans charged off		(350)
Loans modified and returned to performing		(39)
Other adjustments <sup>(1)</sup>		(91)
Non-performing loans as of December 31, 2014		1,286

Note:

- (1) Represents loans paid down or paid off and loans returned to performing other than as a result of modification. We do not separately collect and analyze data relating to non-performing loans other than those that were sold, charged off, modified and returned to performing, or transferred to held-for-sale investment portfolio.

**Allocation of Allowance for Loan Losses**

The following table presents, as of the dates indicated, the allocation of our loan loss allowance by loan type.

	As of December 31,									
	2010		2011		2012		2013		2014	
	(In billions of Won, except percentages)									
	Loans % of Total		Loans % of Total		Loans % of Total		Loans % of Total		Loans % of Total	
	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans	Amount	Loans
<b>Corporate</b>										
Corporate loans	₩ 1,923	67.43%	₩ 1,634	63.41%	₩ 1,700	60.71%	₩ 1,576	63.65%	₩ 1,502	60.05%
Public and other	15	0.53	19	0.74	14	0.50	10	0.40	11	0.44
Loan to banks	32	1.12	13	0.50	11	0.39	5	0.20	12	0.48
Lease financing	17	0.60	14	0.54	33	1.18	21	0.85	26	1.04
	1,987	69.68	1,680	65.19	1,758	62.78	1,612	65.10	1,551	62.01



Total  
corporate

<b>Retail</b>										
Mortgages and home equity	17	0.60	19	0.74	23	0.82	26	1.05	31	1.24
Other retail	178	6.24	202	7.84	275	9.82	190	7.68	198	7.92
Total retail	195	6.84	221	8.58	298	10.64	216	8.73	229	9.16
<b>Credit cards</b>	670	23.48	676	26.23	744	26.58	648	26.17	721	28.83

Total  
allowance  
for loan  
losses

	₩2,852	100.00%	₩2,577	100.00%	₩2,800	100.00%	₩2,476	100.00%	₩2,501	100.00%
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Our total allowance for loan losses increased by ₩25 billion, or 1.01%, to ₩2,501 billion as of December 31, 2014 from ₩2,476 billion as of December 31, 2013, primarily as the result of an increase in the volumes of the credit card purchase and credit card loans and an increase in the loss rate of credit card loans mainly due to deterioration of the asset quality for such loans.

Our total allowance for loan losses decreased by ₩324 billion, or 11.57%, to ₩2,476 billion as of December 31, 2013 from ₩2,800 billion as of December 31, 2012. During 2013, the allowance for loan losses decreased primarily as a result of a decrease in the loss rate for other retail loans due to a decrease in overall delinquency of retail loans following an increase in loans with sound quality.

**Table of Contents****Analysis of Allowance for Loan Losses**

The following table presents an analysis of our loan loss experience for each of the years indicated.

	2010	2011	2012	2013	2014
	(In billions of Won, except percentages)				
Balance at the beginning of the period	₩ 3,114	₩ 2,852	₩ 2,585	₩ 2,800	₩ 2,476
Amounts charged against income	1,301	864	1,325	1,082	895
Gross charge-offs:					
Corporate:					
Corporate loans	(1,292)	(960)	(844)	(799)	(515)
Public and other	(19)	(1)	(1)		
Loan to banks					
Lease financing	(18)	(14)	(19)	(33)	(16)
Retail:					
Mortgage and home equity	(25)	(1)	(4)	(4)	(3)
Other retail	(76)	(80)	(130)	(242)	(153)
Credit cards	(429)	(447)	(486)	(657)	(500)
Total gross charge-offs	(1,859)	(1,503)	(1,484)	(1,735)	(1,187)
Recoveries:					
Corporate:					
Corporate loans	83	75	75	150	177
Public and other			6		11
Loan to banks					
Lease financing	1	2	2	1	2
Retail:					
Mortgage and home equity	2	6			
Other retail	52	37	32	28	19
Credit cards	327	283	257	217	182
Total recoveries	465	403	372	396	391
Other	(169)	(39)	2	(67)	(74)
Net charge-offs	(1,563)	(1,139)	(1,110)	(1,406)	(870)
Balance at the end of the period	₩ 2,852	₩ 2,577	₩ 2,800	₩ 2,476	₩ 2,501
Ratio of net charge-offs during the period to average loans outstanding during the period	1.06%	0.78%	0.55%	0.68%	0.41%
<b>Loan Charge-offs</b>					

Our gross charge-offs increased from ₩1,484 billion in 2012 to ₩1,735 billion in 2013, primarily due to an increase in charge-off of impaired retail loans as part of our efforts to enhance the overall quality of our assets. Our gross charge-offs decreased from ₩1,735 billion in 2013 to ₩1,187 billion in 2014, primarily due to a decrease in charge-off of corporate loans as a result of a slowdown in the deterioration in the asset quality for corporate loans in 2014 as compared to 2013, which was primarily due to a decrease in impaired assets following a substantial charge-off of impaired loans to shipbuilding and construction companies in 2013.

In 2014, the charge-off on restructured loans amounted to ₩55 billion, of which ₩32 billion was related to loans converted into equity securities as part of restructuring. With respect to a loan that we consider to be uncollectible regardless of any modification of terms, we convert a portion of such loan into equity securities following negotiation with the borrower and charge off the remainder of such loan as previously discussed in [Troubled Debt Restructurings Charge-off of Loans Subject to Restructuring](#). The equity securities so

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converted are recorded at fair value, based on the market value of such securities if available or the appraisal value of such securities by an outside appraiser if a market value is unavailable.

### *Basic Principles*

We attempt to minimize loans to be charged off by practicing a sound credit approval process based on credit risk analysis prior to extending loans and a systematic management of outstanding loans. For charge-off of restructured loans, see [Loan Modification Programs for Loans under Restructuring](#) [Charge-off of Restructured Loans](#) above.

### *Loans to be Charged-off*

Loans are charged off if they are deemed to be uncollectible by falling under any of the following categories:

loans for which collection is not foreseeable due to insolvency or bankruptcy, dissolution or the termination of the debtor's business;

loans for which collection is not foreseeable due to the death or disappearance of debtors;

loans for which collection expenses exceed the collectable amount;

loans for which collection is not possible through legal or any other means;

payments in arrears in respect of credit cards that are overdue for more than six months;

payments outstanding on unsecured retail loans that are overdue for more than six months;

payments in arrears in respect of leases that are overdue for more than 12 months; or

the portion of loans classified as estimated loss, net of any recovery from collateral, which is deemed to be uncollectible.

### *Procedure for Charge-off Approval*

An application for Shinhan Bank's loans to be charged off is submitted by the relevant branch to the Corporate Credit Collection Department in the case of corporate loans and foreign branches, and the Consumer Credit Collection Department in the case of retail loans. An application for charge-off is generally submitted immediately after the relevant loan becomes 180 days past due. The General Manager in charge of review evaluates the application. The General Manager of Audit and Examination Department conducts review of compliance with our internal procedures for charge-offs, and if the review is satisfactory, requests approval from the President of Shinhan Bank. As for Shinhan Card, it generally charges off receivables that are 180 days past due following internal review.

*Treatment of Loans Charged-off*

Once loans are charged off, they are derecognized from our statements of financial position. We continue collection efforts in respect of these loans through third-party collection agencies, including the Korea Asset Management Corporation, and Shinhan Credit Information, which is our subsidiary.

*Treatment of Collateral*

When we determine that a loan collateralized by real estate cannot be recovered through normal collection channels, we generally petition a court to foreclose and sell the collateral through a court-supervised auction within one month after default and insolvency and within four months after delinquency. However, this procedure does not apply to companies under restructuring, recovery proceedings, workout or other court

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proceedings where there are restrictions on such auction procedures. Filing of such petition with the court generally encourages the debtor to repay the overdue loan. If a debtor ultimately fails to repay and the court grants its approval for foreclosure, we sell the collateral and recover the principal amount and interest accrued up to the sales price, net of expenses incurred from the auction. Foreclosure proceedings under the laws and regulations of Korea typically take seven months to one year from initiation to collection depending on the nature of the collateral.

### *Financial Statement Presentation*

Our financial statements report as charges-offs all unsecured retail loans, including credit cards, which are overdue for more than six months. Leases are charged off when past due for more than twelve months. For collateral dependent loans, we charge off the excess of the book value of the subject loan over the amount received or to be received from the sale of the underlying collateral when the collateral is sold as part of a foreclosure proceeding and its sale price becomes known through court publication as part of such proceeding.

## **Investment Portfolio**

### *Investment Policy*

We invest in and trade Won-denominated and, to a lesser extent, foreign currency-denominated securities for our own account in order to:

maintain the stability and diversification of our assets;

maintain adequate sources of back-up liquidity to match our funding requirements; and

supplement income from our core lending activities.

When making an investment decision with respect to particular securities, we consider macroeconomic trends, industry analysis and credit evaluation, among others.

Our securities investment activities are subject to a number of regulatory guidelines, including limitations prescribed under the Financial Holding Companies Act and the Banking Act. Generally, a financial holding company is prohibited from acquiring more than 5% of the total issued and outstanding shares of another company (other than its direct and indirect subsidiaries). Furthermore, under these regulations, Shinhan Bank must limit its investments in shares and securities with a maturity in excess of three years (other than monetary stabilization bonds issued by the Bank of Korea and national government bonds) to 100.0% of the sum of Tier I and Tier II capital (less any deductions) of Shinhan Bank. Generally, Shinhan Bank is also prohibited from acquiring more than 15.0% of the shares with voting rights issued by any other corporation (other than for the purpose of establishing or acquiring a subsidiary). Further information on the regulatory environment governing our investment activities is set out in Supervision and Regulation Principal Regulations Applicable to Banks Restrictions on Investments in Property , Principal Regulations Applicable to Banks Restrictions on Shareholdings in Other Companies , Principal Regulations Applicable to Financial Holding Companies Liquidity and Principal Regulations Applicable to Financial Holding Companies Restrictions on Shareholdings in Other Companies.



**Table of Contents****Book Value and Market Value**

The following table sets out the book value and market value of investments in our investment portfolio as of the dates indicated.

	As of December 31, 2012		As of December 31, 2013 <sup>(1)</sup>		As of December 31, 2014	
	Book Value	Market Value	Book Value	Market Value	Book Value	Market Value
<b>Financial assets designated at fair value</b>						
Marketable equity securities	₩ 1,689	₩ 1,689	₩ 2,173	₩ 2,173	₩ 1,318	₩ 1,318
Debt securities:						
Korean treasury and governmental agencies	87	87	172	172	60	60
Debt securities issued by financial institutions	175	175	229	229	539	539
Corporate debt securities	591	591	780	780	816	816
Debt securities issued by foreign government						
Mortgage-backed and asset-backed securities			7	7	4	4
Others						
Total Fair Value Through Profit and Loss	₩ 2,542	2,542	3,361	3,361	2,737	2,737
<b>Available-for-sale securities</b>						
Marketable equity securities	₩ 4,971	₩ 4,971	₩ 4,888	₩ 4,888	₩ 4,562	₩ 4,562
Debt securities:						
Korean treasury and governmental agencies	5,053	5,053	3,707	3,707	3,083	3,083
Debt securities issued by financial institutions	13,750	13,750	12,842	12,842	11,922	11,922
Corporate debt securities	11,633	11,633	10,594	10,594	10,515	10,515
Debt securities issued by foreign government	394	394	589	589	589	589
Mortgage-backed and asset-backed securities	483	483	977	977	747	747
Total Available-for-sale	₩ 36,284	₩ 36,284	₩ 33,597	₩ 33,597	₩ 31,418	₩ 31,418
<b>Held-to-maturity securities</b>						
Debt securities:						
Korean treasury and governmental agencies	₩ 5,613	₩ 6,003	₩ 5,585	₩ 5,828	₩ 7,723	₩ 8,344



Debt securities issued by financial institutions	1,701	1,758	1,406	1,426	1,574	1,607
Corporate debt securities	4,182	4,358	3,785	3,874	3,860	4,049
Debt securities issued by foreign government	104	104	135	135	62	62
Mortgage-backed and asset-backed securities	60	61	120	117	154	160
<b>Total Held-to-maturity</b>	<b>₩ 11,660</b>	<b>₩ 12,284</b>	<b>₩ 11,031</b>	<b>₩ 11,380</b>	<b>₩ 13,373</b>	<b>₩ 14,222</b>
<b>Trading Securities</b>						
Marketable equity securities	₩ 2,377	₩ 2,377	₩ 2,693	₩ 2,693	₩ 2,861	₩ 2,861
Debt securities:						
Korean treasury and governmental agencies	992	992	866	866	1,942	1,942
Financial institutions	5,770	5,770	6,035	6,035	8,312	8,312
Corporations	6,934	6,934	7,676	7,676	10,731	10,731
Mortgage-backed and asset-backed securities	141	141	679	679	189	189
Debt securities issued by foreign governments	2	2	7	7	103	103
Other trading assets	438	438	77	77	224	224
<b>Total Trading</b>	<b>16,654</b>	<b>16,654</b>	<b>18,033</b>	<b>18,033</b>	<b>24,362</b>	<b>24,362</b>
<b>Total securities</b>	<b>₩ 67,140</b>	<b>₩ 67,764</b>	<b>₩ 66,022</b>	<b>₩ 66,371</b>	<b>₩ 71,890</b>	<b>₩ 72,739</b>

*Note:*

- (1) The amounts as of December 31, 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us as described in Note 48 of the notes to our consolidated financial statements.

**Table of Contents****Maturity Analysis**

The following table categorizes our securities by maturity and weighted average yield as of December 31, 2014.

	As of December 31, 2014														
	1 Year or Less		Over 1 but within 5		Over 5 but within 10 Years		Over 10 Years		Total						
	Weighted		Weighted	Weighted	Weighted	Weighted	Weighted	Weighted	Weighted	Weighted					
	Carrying Average	Yield <sup>(1)</sup>	Carrying Average	Yield <sup>(1)</sup>	Carrying Average	Yield <sup>(1)</sup>	Carrying Average	Yield <sup>(1)</sup>	Carrying Average	Yield <sup>(1)</sup>	Carrying Average	Yield <sup>(1)</sup>			
	Amount		Amount		Amount		Amount		Amount		Amount				
	(In billions of Won, except percentages)														
<b>Financial assets designated at fair value:</b>															
Korean treasury securities and government agencies	₩		₩	41	3.62%	₩	19	4.02%	₩		₩	60	3.75%		
Debt securities issued by financial institutions		20	3.43%	288	3.00	231	3.92				539	3.41			
Corporate debt securities		60	3.78	659	3.26	97	3.31				816	3.30			
Mortgage Backed Securities and asset Backed Securities				4	8.62						4	8.62			
Total	₩	80	3.69%	₩	992	3.22%	₩	347	3.76%		₩	1,419	3.38%		
<b>Available-for-sale securities:</b>															
Korean treasury securities and government agencies	₩	242	3.30%	₩	2,174	2.73%	₩	549	2.99%	₩	118	3.13%	₩	3,083	2.83%
Debt securities issued by financial institutions		5,353	2.79	6,154	2.70	405	3.41	10	4.52		11,922	2.77			
Corporate debt securities		2,690	3.56	6,880	2.91	668	3.20	277	4.67		10,515	3.11			
Debt securities issued by foreign governments		170	3.51	328	7.85	12	5.77	79	3.87		589	6.02			
		377	2.79	236	3.22	134	3.33				747	3.02			

## Mortgage-backed securities and asset-backed securities

Total	₩ 8,832	3.05%	₩ 15,772	2.91%	₩ 1,768	3.21%	₩ 484	4.05%	₩ 26,856	2.99%
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**Held-to-maturity securities:**

Korean treasury securities and government agencies	₩ 450	4.81%	₩ 4,247	3.78%	₩ 818	3.01%	₩ 2,208	3.87%	₩ 7,723	3.78%
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Debt securities issued by financial institutions	679	3.24	384	4.37	277	4.18	234	4.11	1,574	3.81
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Corporate debt securities	953	4.06	1,627	3.47	525	3.97	755	3.97	3,860	3.78
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Debt securities issued by foreign governments	1	7.38	14	6.39	47	4.66			62	5.08
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Mortgage-backed securities and asset-backed securities	10	2.45	40	2.79	20	3.15	84	3.66	154	3.29
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Total	₩ 2,093	3.95%	₩ 6,312	3.73%	₩ 1,687	3.55%	₩ 3,281	3.90%	₩ 13,373	3.79%
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**Trading securities:**

Korean treasury securities and government agencies	₩ 295	2.91%	₩ 1,211	2.38	₩ 332	3.38%	₩ 104	3.69%	₩ 1,942	2.70%
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Debt securities issued by financial institutions	5,583	2.32	2,702	2.04	23	3.35	4	6.21	8,312	2.23
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Corporate debt securities	8,119	2.42	2,540	2.56	59	3.80	13	2.21	10,731	2.46
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Debt securities issued by foreign governments	87	3.94	16	3.79					103	3.91
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Mortgage-backed securities and asset-backed securities	179	2.70	10	3.11					189	2.72
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Total	₩ 14,263	2.41%	₩ 6,479	2.32%	₩ 414	3.44%	₩ 121	3.61%	₩ 21,277	2.40%
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Total	₩ 25,268		₩ 29,555		₩ 4,216		₩ 3,886		₩ 62,925	
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*Note:*

(1) The weighted-average yield for the portfolio represents the yield to maturity for each individual security, weighted using its amortized cost.

**Table of Contents****Concentrations of Risk**

The following table presents securities held by us whose aggregate book value exceeded 10% of our stockholders equity as of December 31, 2014. As of December 31, 2014, 10% of our stockholders equity was ₩3,051 billion.

Name of issuer:	As of December 31, 2014	
	Book Value	Fair Value
	(In billions of Won)	
Ministry of Strategy and Finance	₩ 10,324	₩ 10,930
The Bank of Korea	₩ 5,033	₩ 5,034

All of the above entities are either an agency of the Korean government or an entity controlled by the Korean government.

**Credit-Related Commitments and Guarantees**

In the normal course of our operations, we make various commitments and guarantees to meet the financing and other business needs of our customers. Commitments and guarantees are usually in the form of, among others, commitments to extend credit, commercial letters of credit, standby letters of credit and performance guarantees. The contractual amount of these financial instruments represents the maximum possible loss amount if the account party draws down the commitment or we should fulfill our obligation under the guarantee and the account party fails to perform under the contract.

The following table sets forth our credit-related commitments and guarantees as of the dates indicated.

	2012	As of December 31,	
		2013	2014
	(In billions of Won)		
Commitments to extend credit	₩ 71,256	₩ 73,464	₩ 74,449
Commercial letters of credit	3,115	3,045	2,987
Other <sup>(1)</sup>	26,444	26,743	28,742
Total	₩ 100,815	₩ 103,252	₩ 106,178

Note:

- (1) Consists of financial guarantees, performance guarantees, liquidity facilities to special purpose entities, acceptances, guarantee on trust accounts and endorsed bills.

We have credit-related commitments that are not reflected on our statements of financial position, which primarily consist of commitments to extend credit and commercial letters of credit. Commitments to extend credit, including credit lines, represent unfunded portions of authorizations to extend credit in the form of loans. These commitments expire on fixed dates and a customer is required to comply with predetermined conditions to draw funds under the commitments. Commercial letters of credit are undertakings on behalf of customers authorizing third parties to make drawdowns up to a stipulated amount under specific terms and conditions. They are generally short-term and collateralized by the underlying shipments of goods to which they relate.

We also have guarantees that are recorded on our statements of financial position at their fair value at inception which are amortized over the life of the guarantees. Such guarantees generally include standby letters of credit, other financial and performance guarantees and liquidity facilities to special purpose entities. Standby letters of credit are irrevocable obligations to pay third-party beneficiaries when our customers fail to repay loans or debt instruments, which are generally in foreign currencies. A substantial portion of these standby letters of

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credit are secured by collateral, including trade-related documents. Other financial and performance guarantees are irrevocable assurances that we will pay beneficiaries if our customers fail to perform their obligations under certain contracts. Liquidity facilities to special purpose entities are irrevocable commitments to provide contingent liquidity credit lines to special purpose entities established by our customers in the event that a triggering event such as shortage of cash occurs.

The commitments and guarantees do not necessarily represent our exposure since they often expire unused.

**Derivatives**

As discussed under Business Overview Our Principal Activities Corporate and Investment Banking Services Derivatives Trading above, we engage in derivatives trading activities primarily on behalf of our customers so that they may hedge their risks and also enter into back-to-back derivatives with other financial institutions to cover exposures arising from such transactions. In addition, we enter into derivatives transactions to hedge against risk exposures arising from our own assets and liabilities, some of which are nontrading derivatives that do not qualify for hedge accounting treatment.

The following shows, as of December 31, 2014, the gross notional or contractual amounts of derivatives held or issued for (i) trading and (ii) nontrading that qualify for hedge accounting.

	<b>As of December 31, 2014</b>		
	<b>Underlying Notional Amount<sup>(1)</sup></b>	<b>Estimated Fair Value Assets</b>	<b>Estimated Fair Value Liabilities</b>
	<b>(In billions of Won)</b>		
<b>Trading:</b>			
Foreign exchange derivatives:			
Future and forward contracts	₩ 32,211	₩ 440	₩ 510
Swaps	14,363	247	273
Options	775	4	5
Sub-total	47,349	₩ 691	₩ 788
Interest rate derivatives:			
Future and forward contracts	₩ 1,237	₩	₩
Swaps	80,217	564	509
Options	1,861	10	17
Sub-total	₩ 83,315	₩ 574	₩ 526
Credit derivatives:			
Swaps	₩ 385	₩ 2	₩ 15
Sub-total	₩ 385	₩ 2	₩ 15

Equity derivatives:			
Swaps and forward contracts	₩ 4,168	₩ 59	₩ (17)
Options	2,843	67	146
Future contracts	224		
Sub-total	7,235	₩ 126	₩ 129
Commodity derivatives:			
Swaps and forward contracts	₩ 1,170	₩ 14	₩ 133
Options	41	2	
Future contracts	159	2	5
Sub-total	₩ 1,370	₩ 18	₩ 138
Total	₩ 139,654	₩ 1,411	₩ 1,596



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	As of December 31, 2014		
	Underlying Notional Amount <sup>(1)</sup>	Estimated Fair Value Assets	Estimated Fair Value Liabilities
	(In billions of Won)		
<b>Nontrading:</b>			
Hedge accounting:			
Foreign exchange derivatives:			
Swaps	₩ 2,179	₩ 1	₩ 20
Future and forward contracts	685	39	51
Interest rate derivatives:			
Swaps	8,307	117	51
Total	₩ 11,171	₩ 157	₩ 122

*Note:*

(1) Notional amounts in foreign currencies were converted into Won at prevailing exchange rates as of December 31, 2014.

**Funding**

We obtain funding from a variety of sources, both domestic and foreign. Our principal source of funding is customer deposits obtained from our banking operations, and we from time to time issue equity and debt securities, including preferred shares. In addition, our subsidiaries acquire funding through call money, borrowings from the Bank of Korea, other short-term borrowings, corporate debentures and other long-term debt, including debt and equity securities issuances, asset-backed securitizations and repurchase transactions, to complement, or if necessary, replace funding through customer deposits. For further details relating to funding by us and our subsidiaries, see Item 5.B. Liquidity and Capital Resources.

**Deposits**

Although the majority of our bank deposits are short-term, the majority of our depositors have historically rolled over their deposits at maturity, providing our banking operation with a stable source of funding.

The following table shows the average balances of our deposits and the average rates paid on our deposits for the periods indicated.

2012		2013		2014	
Average Balance <sup>(1)</sup>	Average Rate Paid	Average Balance <sup>(1)</sup>	Average Rate Paid	Average Balance <sup>(1)</sup>	Average Rate Paid

**(In billions of Won, except percentages)**

<b>Interest-bearing deposits:</b>						
Demand deposits	₩ 17,233	0.68%	₩ 19,531	0.65%	₩ 21,871	0.57%
Savings deposits	38,655	1.24	40,139	0.96	45,622	0.87
Time deposits	109,743	3.63	112,134	3.00	112,469	2.58
Other deposits	1,875	3.26	1,680	2.01	2,151	1.32
<b>Total interest-bearing deposits</b>	<b>₩ 167,506</b>	<b>2.77%</b>	<b>₩ 173,484</b>	<b>2.26%</b>	<b>₩ 182,113</b>	<b>1.89%</b>

*Note:*

- (1) Average balances are based on (a) daily balances of Shinhan Bank and (b) quarterly balances for other subsidiaries.

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For a breakdown of deposit products, see Our Principal Activities Deposit-taking Activities, except that cover bills sold are recorded on short-term borrowings and securities sold under repurchase agreements are recorded as secured borrowings.

*Certificates of Deposit and Other Time Deposits*

The following table presents the balance and remaining maturities of certificates of deposit and other time deposits which had a fixed maturity in excess of ₩100 million or more as of December 31, 2014.

	<b>As of December 31, 2014</b>		
	<b>Certificates of Deposit</b>	<b>Other Time Deposits</b>	<b>Total</b>
	<b>(In billions of Won)</b>		
Maturing within three months	₩ 1,248	₩ 31,234	₩ 32,482
After three but within six months	284	21,725	22,009
After six but within 12 months	434	24,051	24,485
After 12 months	96	5,436	5,532
<b>Total</b>	<b>₩ 2,062</b>	<b>₩ 82,446</b>	<b>₩ 84,508</b>

A majority of our certificates of deposit accounts and other time deposits issued by our foreign offices is in the amount of US\$100,000 or more.

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The following table presents information regarding our short-term borrowings (borrowings with an original maturity of one year or less) for the periods indicated.

Average Balance Outstanding	2012			Year-end Interest Rate	Average Balance Outstanding	2013			Year-end Interest Rate	Average Balance Outstanding	2014
	Highest Weighted Balances at Any Month-end	Average Interest Rate <sup>(2)</sup>	(In billions of Won, except for percentages)			Highest Weighted Balances at Any Month-end	Average Interest Rate <sup>(2)</sup>	(In billions of Won, except for percentages)			
1,159	₩ 1,510	1.20%	0.10 - 1.50%	₩ 1,385	₩ 1,373	₩ 1,531	0.97%	0.10 - 1.25%	₩ 1,478	₩ 1,251	₩ 1,385
2,402	2,861	4.50	0.07 - 9.00	1,403	2,397	3,335	2.93	0.01 - 5.08	2,649	2,942	3,335
7,555	12,069	1.63	0.00 - 14.00	9,007	5,540	9,925	1.52	0.00 - 6.17	12,809	10,750	12,069
1,116	₩ 16,440	2.24%		₩ 11,795	₩ 9,310	₩ 14,791	1.80%		₩ 16,936	₩ 14,943	₩ 18,000

*Notes:*

- (1) Average balances are based on (a) daily balances of Shinhan Bank and (b) quarterly balances for other subsidiaries.
- (2) Weighted-average interest rates are calculated by dividing the total interest expenses by the average amount borrowed.
- (3) Borrowings from the Bank of Korea generally mature within one month for borrowings in Won and six months for borrowings in foreign currencies.
- (4) Other short-term borrowings included borrowings from trust accounts, bills sold, and borrowings in domestic and foreign currencies.

Our short-term borrowings have maturities of less than one year which are generally unsecured with the exception of borrowings from the Bank of Korea, which are generally secured with available-for-sale or held-to-maturity securities held by us.

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**Risk Management**

***Overview***

As a financial services provider, we are exposed to various risks relating to our lending, credit card, insurance, securities investment, trading and leasing businesses, our deposit taking and borrowing activities and our operating environment. The principal risks to which we are exposed are credit risk, market risk, interest rate risk, liquidity risk and operational risk. These risks are recognized, measured and reported in accordance with risk management guidelines established at our holding company level and implemented at the subsidiary level through a carefully stratified checks-and-balances system.

We believe that our risk management system has been instrumental to building our reputation as a well-managed and prudent financial service provider and withstanding various external shocks. In particular, during the global financial crisis of 2008 and 2009, we believe our risk management provided effective early warning signals which helped us to proactively reconfigure our asset portfolio and substantially reduce our exposure to troubled debtors and thereby avoid what could have been a substantially greater credit loss during such crisis, and we are carefully upgrading and refining our risk management system in the face of current and potential economic difficulties at global, regional and domestic levels.

In particular, our group-wide risk management is guided by the following core principles:

carrying out all business activities within prescribed risk tolerance levels and prudently balancing profitability and risk management;

standardizing the risk management process and monitoring compliance at a group-wide level;

operating a prudent risk management decision making system backed by active participation by management;

creating and operating a risk management organization independent of business activities;

operating a performance management system that enhances clear and prompt identification of risks when making business decisions;

aiming to achieve preemptive and practical risk management; and

prudent preparation for known and unknown contingencies.

We take the following steps to implement the foregoing risk management principles:

*risk capital management* Risk capital refers to capital necessary to compensate for losses in case of a potential risk being realized, and risk capital management refers to the process of asset management based on considerations of risk exposure and risk appetite for our total assets so that we can maintain an appropriate level of risk capital. As part of our risk capital management, we and our subsidiaries have adopted and maintain various risk planning processes and reflect such risk planning in our business and financial planning. We also maintain a risk limit management system to ensure that risks in our business do not exceed prescribed limits.

*risk monitoring* We proactively, preemptively and periodically review risks that may impact our overall operations, including through a multidimensional risk monitoring system. Currently, each of our subsidiaries is required to report to the holding company any factors that could have a material impact on group-wide risk management, and the holding company reports to our chief risk officer and other members of our senior management the results of risk monitoring weekly, monthly and on an *ad hoc* basis as needed. In addition, we perform preemptive risk management through a risk dashboard system under which we closely monitor any increase in asset size, risk levels and sensitivity to external factors with respect to the major asset portfolios of each of our subsidiaries, and to the extent such monitoring yields any warning signals, we promptly analyze the causes and, if necessary, formulate and implement actions in response thereto.

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*risk review* Prior to entering any new business, offering any new products or changing any major policies, we review any relevant risk factors based on a prescribed risk management checklist and, in the case of changes for which assessment of risk factors is difficult, perform reasonable decision-making in order to avoid taking any unduly risky action. The risk management departments of all our subsidiaries are required to review all new businesses, products and services prior to their launch and closely monitor the development of any related risks following their launch, and in the case of any action that involves more than one subsidiary, the relevant risk management departments are required to consult with the risk management team at the holding company level prior to making any independent risk reviews.

*crisis management* We maintain a group-wide risk management system to detect the early warnings signals of any crisis and, in the event of a crisis actually happening, to respond on a timely, efficient and flexible basis so as to ensure our survival as a going concern. Each of our subsidiaries maintains crisis planning for three levels of contingencies, namely, alert, imminent crisis and crisis, determination of which is made based on quantitative and qualitative monitoring and consequence analysis, and upon the occurrence of any such contingency, is required to respond according to a prescribed contingency plan. At the holding company level, we maintain and install a crisis detection and response system which is applied consistently group-wide, and upon the occurrence of an imminent crisis or crisis event at a subsidiary level, we directly take charge of the situation at the holding company level so that we manage it on a concerted group-wide basis.

**Organization**

Our risk management system is organized along the following hierarchy (from top to bottom): at the holding company level, the Group Risk Management Committee, the Group Risk Management Council, the Group Chief Risk Officer and the Group Risk Management Team, and at the subsidiary level, the Risk Management Committee, the Chief Risk Officer and the Risk Management Team of the relevant subsidiary. The Group Risk Management Committee, which is under the supervision of our holding company's board of directors, sets the basic group-wide risk management policies and strategies. Our Group Chief Risk Officer reports to the Group Risk Management Committee, and the Group Risk Management Council coordinates the risk management policies and strategies at the group level as well as at the subsidiary level among each of our subsidiaries. Each of our subsidiaries also has a separate Risk Management Committee, Risk Management Working Committee and Risk Management Team, whose tasks are to implement the group-wide risk management policies and strategies at the subsidiary level as well as to set risk management policies and strategies specific to such subsidiary in line with the group-wide guidelines. We also have the Group Risk Management Team, which supports our Chief Risk Officer in his or her risk management and supervisory role.

In order to maintain the group-wide risk at an appropriate level, we use a hierarchical risk limit system under which the Group Risk Management Committee assigns reasonable risk limits for the entire group and each of our subsidiaries, and the Risk Management Committee and the Risk Management Working Committee of each of our subsidiaries manage the subsidiary-specific risks by establishing and managing risk limits in more detail by type of risk and type of product for each department and division within such subsidiary. Further details follow.

At the holding company level:

*Group Risk Management Committee* The Group Risk Management Committee consists of three outside directors of our holding company. The Group Risk Management Committee convenes at least quarterly and on an *ad hoc* basis as needed. Specifically, the Group Risk Management Committee does the following:

(i) establish the overall risk management policies consistent with management strategies, (ii) set reasonable risk limits for the entire group and each of our subsidiaries, (iii) approve appropriate investment limits or permissible loss limits, (iv) enact and amend risk management regulations, and (v) decide other risk management-related issues the board of directors or the Group Risk Management



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Committee sees fit to discuss. The results of the Group Risk Management Committee meetings are reported to the board of directors of our holding company. The Group Risk Management Committee makes decisions through affirmative votes by a majority of the committee members.

*Group Risk Management Council* Comprised of the Group Chief Risk Officer, Group Risk Management Team head, and Chief Risk Officers of each of our subsidiaries, the Group Risk Management Council provides a forum for risk management executives from each subsidiary to discuss our group-wide risk management guidelines and strategy in order to maintain consistency in the group-wide risk policies and strategies.

*Group Chief Risk Officer* The Group Chief Risk Officer assists the Group Risk Management Committee by implementing the risk policies and strategies as well as ensuring consistency in the risk management systems of our subsidiaries. Furthermore, the Group Chief Risk Officer evaluates the Chief Risk Officer of each subsidiary in addition to monitoring the risk management practices of each subsidiary.

*Group Risk Management Team* This team provides support and assistance to the Group Chief Risk Officer in carrying out his or her responsibilities.

At the subsidiary level:

*Risk Management Committee* In order to maintain group-wide risk at an appropriate level, we have established a hierarchical risk limit system where the Group Risk Management Committee establishes risk limits for us and our subsidiaries, and each of our subsidiaries establishes and manages risk limits in more detail by type of risk and type of product for each department and division within such subsidiary. In accordance with the group risk management policies and strategies, the Risk Management Committee at the subsidiary level establishes its own risk management policies and strategies in more detail and the respective risk management department implements those policies and strategies.

*Risk Management Team* The Risk Management Team, operating independently from the business units of each of our subsidiaries, monitors, assesses, manages and controls the overall risk of its operations and reports all major risk-related issues to the Group Risk Management Team at the holding company level, which then reports to the Group Chief Risk Officer.

The following is a flowchart of our risk management system at the holding company level and the subsidiary level.

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### **Credit Risk Management**

Credit risk, which is the risk of loss from default by borrowers, other obligors or other counterparties to the transactions that we have entered into, is our greatest risk. Our credit risk management encompasses all areas of credit that may result in potential economic loss, including not just transactions that are recorded on our balance sheets, but also off-balance-sheet transactions such as guarantees, loan commitments and derivatives transactions. A substantial majority of our credit risk relates to the operations of Shinhan Bank and Shinhan Card.

#### **Credit Risk Management of Shinhan Bank**

Shinhan Bank's credit risk management is guided by the following principles:

achieve a profit level corresponding to the level of risks involved;

improve asset quality and achieve an optimal mix of asset portfolios;

avoid excessive loan concentration in a particular borrower or sector;

closely monitor the borrower's ability to repay the debt; and

provide financial support to advance the growth of select customers.

Major policies for Shinhan Bank's credit risk management, including Shinhan Bank's overall credit risk management plan and credit policy guidelines, are determined by the Risk Policy Committee of Shinhan Bank, the executive decision-making body for management of credit risk. The Risk Policy Committee is headed by the Chief Risk Officer, and also comprises of the Chief Credit Officer and the heads of each business. In order to separate the loan approval functions from credit policy decision-making, Shinhan Bank has a Credit Review Committee that performs credit review evaluations with a focus on improving the asset quality of and profitability from the loans being made, and operates separately from the Risk Policy Committee. Both the Risk Policy Committee and the Credit Review Committee make decisions by a vote of two-thirds or more of the attending members of the respective committees, which must constitute at least two-thirds of the respective committee members to satisfy the respective quorum.

Shinhan Bank complies with credit risk management procedures pursuant to internal guidelines and regulations and continually monitors and improves these guidelines and regulations. Its credit risk management procedures include:

credit evaluation and approval;

credit review and monitoring; and

credit risk assessment and control.

***Credit Evaluation and Approval***

All loan applicants and guarantors are subject to credit evaluation before approval of any loans. Credit evaluation of loan applicants are carried out by the relevant lending approval authority of Shinhan Bank. Loan evaluation is carried out by a group rather than by an individual reviewer through an objective and deliberative process. Credit ratings of loan applicants and guarantors influence loan interest rates, approval authority, credit exposure limits, calculation of potential losses and estimated cost of capital, and therefore are determined objectively and independently by the relevant business unit. Shinhan Bank uses a credit scoring system for retail loans and a credit-risk rating system for corporate loans.

Each of Shinhan Bank's borrowers is assigned a credit rating, which is based on a comprehensive internal credit evaluation system that considers a variety of criteria. For retail borrowers, the credit rating takes into account the borrower's biographic details, past dealings with Shinhan Bank and external credit rating information, among other things. For corporate borrowers, the credit rating takes into account financial indicators

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as well as non-financial indicators such as industry risk, operational risk and management risk, among other things. The credit rating, once assigned, serves as the fundamental instrument for Shinhan Bank's credit risk management, and is applied to a wide range of credit risk management processes, including credit approval, credit limit management, loan pricing and computation of allowance for loan losses. Shinhan Bank has separate credit evaluation systems for retail customers, SOHO customers and corporate customers, which are further segmented and refined to meet Basel II requirements, which requirements have not changed under Basel III. See Item 5.A. Operating Results Critical Accounting Policies Impairment of Financial Assets Allowance for Loan Losses.

*Retail Loans*

Loan applications for retail loans are reviewed in accordance with Shinhan Bank's credit scoring system and the objective statistics models for secured and unsecured loans maintained and operated by Shinhan Bank's Retail Banking Division. Shinhan Bank's credit scoring system is an automated credit approval system used to evaluate loan applications and determine the appropriate pricing for the loan, and takes into account factors such as a borrower's personal information, transaction history with Shinhan Bank and other financial institutions and other relevant credit information. The applicant is assigned a score, which is used to determine (i) whether to approve the applicant's loan, (ii) the amount of loan to be granted, and (iii) the interest rates thereon. The applicant's score also determines whether the applicant is approved for credit, conditionally approved, subject to further assessment, or denied. If the applicant becomes subject to further assessment, the appropriate discretionary body, either at the branch level or at the headquarter level, makes a reassessment based on qualitative as well as quantitative factors, such as credit history, occupation and past relationship with Shinhan Bank.

For mortgage and home equity loans and loans secured by real estate, Shinhan Bank evaluates the value of the real estate offered as collateral using a proprietary database, which contains information about real estate values throughout Korea. In addition, Shinhan Bank uses up-to-date information provided by third parties regarding the real estate market and property values in Korea. While Shinhan Bank uses internal staff from the processing centers to appraise the value of the real estate collateral, Shinhan Bank also hires certified appraisers to review and co-sign the appraisal value of real estate collateral that have an appraisal value exceeding ₩5 billion, as initially determined by the processing centers. Shinhan Bank also reevaluates internally, on a summary basis, the appraisal value of collateral at least every year.

For loans secured by securities, deposits or other assets other than real estate, Shinhan Bank requires borrowers to observe specified collateral ratios in respect of secured obligations.

*Corporate Loans*

Shinhan Bank rates all of its corporate borrowers using internally developed credit evaluation systems. These systems consider a variety of criteria (quantitative, qualitative, financial and non-financial) in order to standardize credit decisions and focus on the quality of borrowers rather than the size of loans. The quantitative considerations include the borrower's financial and other data, while the qualitative considerations are based on the judgment of Shinhan Bank's credit officers as to the borrower's ability to repay. Financial considerations include financial variables and ratios based on customer's financial statements, such as return on assets and cash flow to total debt ratios, and non-financial considerations include, among other things, the industry to which the borrower's businesses belong, the borrower's competitive position in its industry, its operating and funding capabilities, the quality of its management and controlling stockholders (based in part on interviews with its officers and employees), technological capabilities and labor relations.

In addition, in order to enhance the accuracy of its internal credit reviews, Shinhan Bank also considers reports prepared by external credit rating services, such as Nice Information Service and Korea Enterprise Data, and monitors and improves the effectiveness of the credit risk-rating systems using a database that it updates continually with actual default records.

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Based on the scores calculated under the credit rating system, which takes into account the evaluation criteria described above and the probability of default, Shinhan Bank assigns the borrower one of 20 grades (from the highest of AAA to the lowest of D). Grades AA through B are further broken down into +, 0 or -. Grades AAA through B- are classified as normal, grade CCC precautionary, and grades CC through D non-performing. The credit risk-rating model is further differentiated by the size of the corporate borrower and the type of credit facilities.

*Loan Approval Process*

Loans are generally approved after evaluations and approvals by the relationship manager at the branch level as well as the committee of the applicable business unit at Shinhan Bank. The approval limit for retail loans is made based on Shinhan Bank's automated credit scoring system. In the case of large corporate loans, approval limits are also reviewed and approved by a Credit Officer at the headquarter level. Depending on the size and the importance of the loan, the approval process is further reviewed by the Credit Officer Committee or the Master Credit Officer Committee. If the loan is considered significant or the amount exceeds the discretion limit of the Master Credit Officer Committee, further evaluation is made by the Credit Review Committee, which is Shinhan Bank's highest decision-making body in relation to credit approval. The Credit Review Committee's evaluation and approval of loan limits vary depending on the credit ratings of the borrowers as determined by Shinhan Bank's internal credit rating system. For example, for borrowers with a credit rating of B-, the Credit Review Committee evaluates and approves unsecured loans in excess of ₩10 billion and secured loans in excess of ₩15 billion, whereas for borrowers with a credit rating of AAA, the Credit Review Committee evaluates and approves unsecured loans in excess of ₩40 billion and secured loans in excess of ₩90 billion. The Credit Review Committee holds at least two meetings a week to approve applications for large-sized loans whose principal amounts exceed prescribed levels set by it.

The chart below summarizes the credit approval process of our banking operation. The Chief Credit Officer and the Head of Business Division do not make individual decisions on loan approval, but are part of the decision-making process at the group level.

The reviewer at each level of the review process may in its discretion approve loans up to a maximum amount per loan assigned to such level. The discretionary loan approval limit for each level of the loan approval process takes into account the total amount of loans extended to the borrower, the credit level of the applicant based on credit review, the existence and value of collateral and the level of credit risk established by the credit rating system. The discretionary loan amount approval limit ranges from ₩30 million for unsecured retail loans with a credit rating of B-, which are subject to approvals by the retail branch manager, to ₩90 billion for secured loans with a credit rating of AAA, which are subject to approvals by the Master Credit Officer Committee. Any loans exceeding the maximum discretionary loan amount approval limit must be approved by the Credit Review Committee.

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**Table of Contents*****Credit Review and Monitoring***

Shinhan Bank continually reviews and monitors existing credit risks primarily with respect to borrowers. In particular, Shinhan Bank's automated early warning system conducts daily examination for borrowers using over 192 financial and non-financial factors, and the relationship manager and the credit officer must conduct periodic loan review and report to an independent loan review team which analyzes in detail the results and adjusts credit ratings accordingly. Based on these reviews, Shinhan Bank adjusts a borrower's credit rating, credit limit, applied interest rates and credit policies. In addition, the group credit rating of the borrower's group, if applicable, may be adjusted following a periodic review of the main debtor groups, mostly comprised of *chaebols*, as identified by the Governor of the Financial Supervisory Service based on their outstanding credit exposures, of which 54 were identified as such as of December 31, 2014. Shinhan Bank also continually reviews other factors, such as industry-specific conditions for the borrower's business and its domestic and overseas asset base and operations, in order to ensure that the assigned ratings are appropriate. The Credit Review Department provides credit review reports, independent of underwriting, to the Chief Risk Officer on a monthly basis.

The early warning system performs automatic daily checks for borrowers to whom Shinhan Bank has more than ₩1 billion of total exposure or ₩500 million of credit exposure. When the early warning system detects a warning signal, the results of such monitoring are reviewed by the Credit Review Department in the case of a borrower to whom Shinhan Bank has more than ₩2 billion of exposure, and the relationship manager and the Credit Officer in the case of a borrower to whom Shinhan Bank has ₩2 billion or less of exposure. In addition, Shinhan Bank carries out a planned review of each borrower in accordance with changing credit risk factors based on the changing economic environment. The results of such planned review are continually reported to the Chief Risk Officer of Shinhan Bank.

The early warning system performs automatic daily checks for borrowers to whom Shinhan Bank has more than ₩1 billion of total exposure (which represents the total outstanding amount due from a borrower, net of collateral for deposit, installment savings, guarantees and import guarantee money) or ₩500 million of net credit exposure (which represents total exposure net of effective collateral). When the early warning systems detects a warning signal, such signal and other findings from the monitoring are reviewed by the Credit Review Department in the case of a borrower to whom Shinhan Bank has more than ₩2 billion of exposure, and by the relationship manager and the Credit Officer in the case of a borrower to whom Shinhan Bank has less than ₩2 billion of exposure. In addition, Shinhan Bank carries out a preemptive review of each borrower in accordance with changes in credit risk factors based on changes in the economic environment. The results of such preemptive review are continually reported to the Chief Risk Officer of Shinhan Bank.

Depending on the nature of the signals detected by the early warning system, a borrower may be classified as deteriorating credit and become subject to evaluation for a possible downgrade in rating, or may be initially classified as showing early warning signs or become reinstated to the normal borrower status. For borrowers classified as showing early warning signs, the relevant relationship manager gathers information and conducts a review of the borrower to determine whether the borrower should be classified as a deteriorating credit or whether to impose management improvement warnings or implement joint creditors' management. If the borrower becomes non-performing, Shinhan Bank's collection department directly manages such borrower's account in order to maximize recovery rate, and conducts auctions, court proceedings, sale of assets or corporate restructuring as needed.

Pursuant to the foregoing credit review and monitoring procedures and in order to promptly prevent deterioration of loan qualities, Shinhan Bank classifies potentially problematic borrowers into (i) borrowers that show early warning signals, (ii) borrowers that require precaution, (iii) borrowers that require observation and (iv) normal borrowers, and treats them differentially accordingly.

In order to curtail delinquency among corporate customers, Shinhan Bank takes primarily the following measures:  
(i) systematic monitoring of borrowers with sizable outstanding loans, (ii) heightened monitoring of



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borrowers with bad credit history and/or belonging to troubled industries and (iii) assignment of industry-specific lending caps, as adjusted for whether specific industries are particularly sensitive to general business cycles and/or are troubled at a given time.

*Systematic monitoring of borrowers with sizable outstanding loans.* Shinhan Bank currently applies a heightened monitoring system to corporate borrowers with outstanding loans (other than guaranteed loans and loans secured by specified types of collaterals such as deposits with us or letters of credit) in the aggregate amount of ₩1 billion or more and borrowers with net outstanding loans (i.e., the outstanding loan amount minus the fair value of collaterals (other than as aforesaid) securing such loans) in the aggregate amount of ₩500 million or more. Under this monitoring system, each such borrower is assigned one of the following ratings:

Normal borrower      a borrower with a credit rating of B- or above that are deemed to carry a low risk of default;

Borrower that requires observation      a borrower that carries some risk of potential default and therefore requires periodic monitoring to detect any elevation of such risk;

Borrower that requires precaution      a borrower with an elevated risk of default and therefore requires detailed reassessment of the credit quality of such borrower and precaution in extending any further loans;

Borrower with early warning signs      a borrower with a high level of default risk; and

Problematic or reorganized borrower      a borrower currently in default and either subject to workout or restructuring or showing no signs of recovery.

Shinhan Bank conducts systematic monitoring of the foregoing borrowers at intervals depending on the borrower's credit rating (for example, every 12 months for normal borrowers with a credit rating of AAA to A, every nine months for normal borrowers with a credit rating of A- to BBB+, every six months for a credit rating of BBB to B- and every three months for borrowers with a credit rating of CCC or below and borrowers not deemed to be normal). In addition, the loan reviewer may request more frequent monitoring if the borrower is showing signs of deteriorating credit quality. For borrowers with outstanding loan amounts of ₩2 billion or more, Shinhan Bank also monitors the revenues and earnings of such borrower on a quarterly basis within 10 weeks following the end of each quarter.

*Heightened monitoring of borrowers with bad credit history and/or belonging to troubled industries.* In addition to the systematic monitoring discussed above, Shinhan Bank also carries out additional monitoring for borrowers that, among others, (i) are rated as requiring observation, requiring precaution or with early warning signs as noted above, (ii) have prior history of delinquency or restructuring or (iii) have borrowings that are classified as substandard or below. Based on the heightened monitoring of these borrowers, Shinhan Bank adjusts contingency planning as to how the overall asset quality of a specific industry should change for each phase of the business cycle, how Shinhan Bank should limit or reduce its exposure to such borrowers, and how our group-wide delinquency and non-performing ratio would change, among other things.

*Assignment of industry-specific lending caps.* Shinhan Bank currently classifies loans to corporate borrowers by industry, and caps the aggregate amount of loans to each industry, which amount varies depending on the respective industry forecasts and industry-specific loan default rates, among other factors. By doing so, Shinhan Bank seeks to avoid concentration of loans in risky industries and subject loans to risky industries to heightened monitoring and risk management.

Shinhan Bank currently places the following industries with relatively high risk profiles on the intensive management watch list for heightened monitoring and management: real estate supply, leasing and service; restaurants; lodging; construction; shipbuilding; shipping; non-metallic minerals and golf operation. For each of these industries, Shinhan Bank enforces a conservative cap on the aggregate amount of loans to such industry,

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and the business units responsible for exceeding such limits are penalized in their performance evaluations, which would have a negative impact on the pay and promotion of the employees belonging to such units.

***Credit Risk Assessment and Control***

In order to assess credit risk in a systematic manner, Shinhan Bank has developed and upgraded systems designed to quantify credit risk based on selection and monitoring of various statistics, including delinquency rate, non-performing loan ratio, expected loan loss and weighted average risk rating.

Shinhan Bank controls loan concentration by monitoring and managing loans at two levels: portfolio level and individual loan account level. In order to maintain portfolio-level credit risk at an appropriate level, Shinhan Bank manages its loans using value-at-risk ( VaR ) limits for the entire bank as well as for each of its business units. In order to prevent concentration of risk in a particular borrower or borrower class, Shinhan Bank also manages credit risk by borrower, industry, country and other detailed categories.

Shinhan Bank measures credit risk using internally accumulated data. Shinhan Bank measures expected and unexpected losses with respect to total assets monthly, which Shinhan Bank refers to when setting risk limits for, and allocating capital to, its business groups. Expected loss is calculated based on the probability of default, the loss given default, the exposure at default and the past bankruptcy rate and recovery rate, and Shinhan Bank provides allowance for loan losses accordingly. Shinhan Bank makes provisioning at a level which is the higher of the Financial Supervisory Service requirement or Shinhan Bank's internal calculation. Unexpected loss is predicted based on VaR, which is used to determine compliance with the aggregate credit risk limit for Shinhan Bank as well as the credit risk limit for the relevant department within Shinhan Bank. Shinhan Bank uses the Advanced Internal Rating-Based ( AIRB ) method as proposed by the Basel Committee to compute VaR at the account-specific level as well as to measure risk adjusted performance.

**Credit Risk Management of Shinhan Card**

Major policies for Shinhan Card's credit risk management are determined by Shinhan Card's Risk Management Council, and Shinhan Card's Risk Management Committee is responsible for approving them. Shinhan Card's Risk Management Council is headed by the Chief Risk Officer, and also comprises of the heads of each business unit, supporting unit and relevant department at Shinhan Card. Shinhan Card's Risk Management Council convenes at least once every month and may also convene on an *ad hoc* basis as needed. Shinhan Card's Risk Management Committee is comprised of three Non-Standing Directors. Shinhan Card's Risk Management Committee convenes at least once every quarter and may also convene on an *ad hoc* basis as needed.

The risk of loss from default by the cardholders or credit card loan borrowers is Shinhan Card's greatest credit risk. Shinhan Card manages its credit risk based on the following principles:

achieve profit at a level corresponding to the level of risks involved;

improve asset quality and achieve an optimal mix of asset portfolios; and

closely monitor borrower's ability to repay the debt.

***Credit Card Approval Process***

Shinhan Card uses an automated credit scoring system to approve credit card applications or credit card authorizations. The credit scoring system is divided into two sub-systems: the behavior scoring system and the application scoring system. The behavior scoring system is based largely on the credit history of the cardholder or borrower, and the application scoring system is based largely on personal information of the applicant. For credit card applicants with whom we have an existing relationship, Shinhan Card's credit scoring system considers internally gathered information such as the ability to repay, total assets, the length of the existing

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relationship and the applicant's contribution to Shinhan Card's profitability. The credit scoring system also automatically conducts credit checks on all credit card applicants. Shinhan Card gathers information about the applicant's transaction history with financial institutions, including banks and credit card companies, from a number of third party credit reporting agencies including, among others, National Information & Credit Evaluation Inc. and Korea Credit Bureau. These credit checks reveal a list of the delinquent customers of all credit card issuers in Korea.

If a credit score assigned to an applicant is above the minimum threshold, the application is approved unless overridden based on other considerations such as delinquencies with other credit card companies. For a credit card application by a long-standing customer with a good credit history, Shinhan Card may, on a discretionary basis, approve the application notwithstanding the assigned credit score unless overridden by other considerations. All of these factors also serve as the basis for setting a credit limit for approved applications.

The following describes the process of how Shinhan Card sets credit limits for credit cards, cash advances and card loans:

*Credit purchase and cash advance limits* These limits are set based on the applicant's limit request and Shinhan Card's credit screening criteria. Unless a cardholder requests a reduction in the credit purchase and/or cash advance limit, Shinhan Card is required to provide prior notice to the cardholder for any reduction in such cardholder's limit. However, if the accountholder defaults or the cardholder's credit limit is reduced according to the terms of the card agreement, Shinhan Card may lower the credit limit before notifying the accountholder.

*Card loan limit* This limit is set monthly by Shinhan Card based on the cardholder's credit rating and transaction history. The card loan limit can be adjusted monthly based on the cardholder's credit standing without prior notification.

***Monitoring***

Shinhan Card continually monitors all cardholders and accounts using a behavior scoring system. The behavior scoring system predicts a cardholder's payment pattern by evaluating the cardholder's credit history, card usage and amounts, payment status and other relevant data. The behavior score is recalculated each month and is used to manage the accounts and approval of additional loans and other products to the cardholder. Shinhan Card also uses the scoring system to monitor its overall risk exposure and to modify its credit risk management strategy.

***Loan Application Review and On-going Credit Review***

When reviewing new applications and conducting an ongoing credit review for retail loans, installment purchase loans and personal leases, Shinhan Card uses criteria substantially similar to those used in the credit underwriting system and the credit review system for cardholders. For retail loans, installment purchase loans and personal leases to existing cardholders, Shinhan Card reviews their card usage history in addition to other factors such as their income, occupation and assets.

***Fraud Loss Prevention***

Shinhan Card seeks to minimize losses from the fraudulent use of credit cards issued by it. Shinhan Card focuses on preventing fraudulent uses and, following the occurrence of a fraudulent use, makes investigations in order to make

the responsible party bear the losses. Misuses of lost credit cards account for a substantial majority of Shinhan Card's fraud-related losses. Through its fraud loss prevention system, Shinhan Card seeks to detect, on a real-time basis, transactions that are unusual or inconsistent with prior usage history and calls are made to the relevant cardholders to confirm their purchases. A team at Shinhan Card dedicated to investigating fraud losses also examines whether the cardholder was at fault by, for example, not reporting a lost card or failing to

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endorse the card, or whether the relevant merchant was negligent in checking the identity of the user. Fault may also lie with delivery companies that fail to deliver credit cards to the relevant applicant. In such instances, Shinhan Card attempts to recover fraud losses from the responsible party. To prevent misuse of a card as well as to manage credit risk, Shinhan Card's information technology system will automatically suspend the use of a card (i) when, as a result of ongoing monitoring, fraudulent use or loss of the card is suspected based on the account holder's credit score, or (ii) at the request of the account holder.

Approximately 80% of Shinhan Card's cardholders consent to Shinhan Card's accessing their travel records to detect any misuse of credit cards while they are traveling abroad. Shinhan Card also offers cardholders additional fraud protection through a fee-based texting service. At the cardholder's option, Shinhan Card notifies the cardholder of any credit card activity in his or her account by sending a text message to his or her mobile phone. This notification service allows customers to quickly and easily identify any fraudulent use of their credit cards.

**Credit Risk Management of Shinhan Investment**

In accordance with the guidelines of the Financial Supervisory Service, Shinhan Investment assesses its credit risks (including through VaR analyses) and allocates the maximum limit for the credit amount at risk by department. Shinhan Investment also assesses the counterparty risks in all credit-related transactions, such as loans, acquisition financings and derivative transactions and takes corresponding risk management measures. In assessing the credit risk of a corporate counterparty, Shinhan Investment considers such counterparty's corporate credit rating obtained from Shinhan Bank's internal corporate rating database. Through its risk management system, Shinhan Investment also closely monitors credit risk exposures by counterparty, industry, conglomerates, credit ratings and country. Shinhan Investment conducts credit risk stress tests on a daily basis based on probability of default and also conducts more advanced stress tests from time to time, the results of which are then reported to its management as well as the Group Chief Risk Officer to support group-wide credit risk management.

**Market Risk Management**

Market risk is the risk of loss generated by fluctuations in market prices such as interest rates, foreign exchange rates and equity prices. The principal market risks to which we are exposed are interest rate risk and, to a lesser extent, foreign exchange risk and equity price risk. These risks stem from our trading and non-trading activities relating to financial instruments such as loans, deposits, securities and financial derivatives. We divide market risk into risks arising from trading activities and risks arising from non-trading activities.

Our market risks arise primarily from Shinhan Bank, and to a lesser extent, Shinhan Investment, our securities trading and brokerage subsidiary, which faces market risk relating to its trading activities.

Shinhan Bank's Risk Policy Committee acts as the executive decision-making body in relation to Shinhan Bank's market risks in terms of setting its risk management policies and risk limits in relation to market risks and assets and controlling market risks arising from trading and non-trading activities of Shinhan Bank. This Committee consists of the deputy presidents of Shinhan Bank's seven business groups, which includes Shinhan Bank's Chief Risk Officer and the Chief Financial Officer. At least on a monthly basis, the Risk Policy Committee reviews and approves reports relating to, among others, the position and VaR of Shinhan Bank's trading activities and the position, VaR, duration gap and market value analysis and net interest income simulation of its non-trading activities. In addition, Shinhan Bank's Risk Management Department comprehensively manages market risks on an independent basis from Shinhan Bank's operating departments, and functions as the middle office of Shinhan Bank. Shinhan Bank measures market risk with respect to all assets and liabilities in bank accounts and trust accounts in accordance with the regulations promulgated by the Financial Services Commission.





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Shinhan Investment manages its market risk based on its overall risk limit established by its risk management committee as well as the risk limits and detailed risk management guidelines for each product and department established by its Risk Management Working Committee. Shinhan Investment's Risk Management Working Committee is the executive decision-making body for managing market risks related to Shinhan Investment, and determines, among other things, Shinhan Investment's overall market risk management policies and strategies, and assesses and approves trading activities and limits. In addition, Shinhan Investment's Risk Management Department manages various market risk limits and monitors operating conditions on an independent basis from Shinhan Investment's operating departments. Shinhan Investment assesses the adequacy of these limits at least annually. In addition, Shinhan Investment assesses the market risks of its trading assets. The assessment procedure is based on the standard procedures set by the Financial Supervisory Service as well as an internally developed model. Shinhan Investment assesses the risk amount and VaR, and manages the risk by setting a risk limit per sector as well as a VaR limit.

Shinhan Life Insurance manages its market risk based on its overall risk limit established by its risk management committee. Shinhan Life Insurance manages market risk in regard to assets that are subject to trading activities and foreign exchange positions.

Shinhan Card does not have any assets with significant exposure to market risks and therefore does not maintain a risk management policy with respect to market risks.

*We use financial information prepared on a separate basis according to IFRS for the market risk management of our subsidiaries and, unless otherwise specified herein, financial information in this annual report presented for quantitative market risk disclosure relating to our subsidiaries have been prepared in accordance with IFRS on a separate basis.*

**Market Risk Exposure from Trading Activities**

Shinhan Bank's trading activities principally consist of:

trading activities to realize short-term profits from trading in the equity and debt securities markets and the foreign currency markets based on Shinhan Bank's short-term forecast of changes in market situation and customer demand, for its own account as well as for the trust accounts of Shinhan Bank's customers; and

trading activities primarily to realize profits from arbitrage transactions involving derivatives such as swaps, forwards, futures and options, and, to a lesser extent, to sell derivative products to Shinhan Bank's customers and to cover market risk associated with those trading activities.

Shinhan Investment's trading activities principally consist of trading for customers and for proprietary accounts equity and debt securities and derivatives based on stock prices, stock indexes, interest rates, foreign currency exchange rates and commodity prices.

As a result of these trading activities, Shinhan Bank is exposed principally to interest rate risk, foreign currency exchange rate risk and equity risk, and Shinhan Investment is exposed principally to equity risk and interest rate risk.

**Interest Rate Risk**

Shinhan Bank's exposure to interest rate risk arises primarily from Won-denominated debt securities, directly held or indirectly held through beneficiary certificates, and, to a lesser extent, from interest rate derivatives. Shinhan Bank's exposure to interest rate risk arising from foreign currency-denominated trading debt securities is minimal since its net position in those securities is not significant. As Shinhan Bank's trading accounts are marked-to-market daily, it manages the interest rate risk related to its trading accounts using VaR, a market value-based tool.

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Shinhan Investment's interest rate risk arises primarily from management of its interest rate-sensitive asset portfolio, which mainly consists of debt securities, interest rate swaps and government bond futures, and the level of such risk exposure depends largely on the variance between the interest rate movement assumptions built into the asset portfolio and the actual interest rate movements and the spread between a derivative product and its underlying assets. Shinhan Investment quantifies and manages the interest rate-related exposure by daily conducting VaR and stress tests on a marked-to-market basis.

*Foreign Currency Exchange Rate Risk*

Shinhan Bank's exposure to foreign currency exchange rate risk mainly relates to its assets and liabilities, including derivatives such as foreign currency forwards and futures and currency swaps, which are denominated in currencies other than the Won. Shinhan Bank manages foreign currency exchange rate risk on a consolidated basis, including the corresponding risks faced by its overseas branches, by covering all of its foreign exchange spot and forward positions in both trading and non-trading accounts.

Shinhan Bank's net foreign currency open position represents the difference between its foreign currency assets and liabilities as offset against forward foreign currency positions, and is Shinhan Bank's principal exposure to foreign currency exchange rate risk. The Risk Policy Committee oversees Shinhan Bank's foreign currency exposure for both trading and non-trading activities by establishing limits for the net foreign currency open position, loss limits and VaR limits. Shinhan Bank centrally monitors and manages its foreign exchange positions through its FX & Derivatives Department. Dealers in the FX & Derivatives Department manage Shinhan Bank's overall position within preset limits through spot trading, forward contracts, currency options, futures and swaps and foreign currency swaps. Shinhan Bank sets a limit for net open positions by currency. The limits for currencies other than the U.S. Dollar, Japanese Yen, Euro and Chinese Yuan are set in a conservative manner in order to minimize trading in such currencies.

Shinhan Investment faces foreign currency exchange rate risk in relation to the following product offerings: currency forwards, currency swaps and currency futures. Shinhan Investment centrally monitors and manages transactions involving such products through its Fixed Income, Currency & Commodities Departments. Shinhan Investment's Risk Management Working Committee, which is delegated with the authority to approve foreign currency-related transactions and limits on the related open positions, manages the related foreign exchange risk by setting nominal limits on the amounts of foreign exchange-related products and monitoring compliance with such limits on a daily basis. As of December 31, 2014, Shinhan Investment's net open position related to foreign currency-related products was US\$(13.8) million, and its open positions related to the sale of Won-U.S. Dollar forwards and Won-U.S. dollar futures were US\$(450.6) million and US\$195.6 million, respectively.

Shinhan Capital faces considerable foreign currency exchange rate exposure in respect of its leasing business, but maintains its net exposure below US\$10 million by hedging its foreign exchange positions using forwards and currency swaps.

The net open foreign currency positions held by our other subsidiaries are insignificant.

The following table shows Shinhan Bank's net foreign currency open positions as of December 31, 2012, 2013 and 2014. Positive amounts represent long exposures and negative amounts represent short exposures.

Currency	As of December 31,		
	2012	2013	2014

	<b>(In millions of US\$)</b>		
U.S. Dollars	US\$ 165.5	US\$ 53.1	US\$ 101.6
Japanese Yen	(54.6)	(54.7)	(72.4)
Euro	2.2	1.8	(1.5)
Others	668.4	698.3	614.8
<b>Total</b>	<b>US\$ 781.7</b>	<b>US\$ 698.5</b>	<b>US\$ 642.6</b>

**Table of Contents***Equity Risk*

Shinhan Bank's equity risk related to trading activities mainly involves trading equity portfolios of Korean companies and Korea Stock Price Index futures and options. The trading equity portfolio consists of stocks listed on the KRX KOSPI Market or the KRX KOSDAQ Market of the Korea Exchange and nearest-month or second nearest-month futures contracts under strict limits on diversification as well as limits on positions. Shinhan Bank maintains strict scrutiny of these activities in light of the volatility in the Korean stock market and closely monitors the loss limits and the observance thereof. Although Shinhan Bank holds a substantially smaller amount of equity securities than debt securities in its trading accounts, the VaR of trading account equity risk is generally higher than that of trading account interest rate risk due to high volatility in the value of equity securities. As of December 31, 2012, 2013 and 2014, Shinhan Bank held ₩165.4 billion, ₩64.6 billion and ₩60.7 billion, respectively, of equity securities in its trading accounts (including the trust accounts).

Shinhan Investment's equity risk related to trading activities also mainly involves the trading of equity portfolio of Korean companies and Korea Stock Price Index futures and options. As of December 31, 2012, 2013 and 2014, the total amount of equity securities at risk held by Shinhan Investment was ₩15.8 billion, ₩16.1 billion and ₩49.1 billion, respectively.

Equity positions held by our other subsidiaries are insignificant.

**Management of Market Risk from Trading Activities**

The following table presents an overview of market risk, measured by VaR, from trading activities of Shinhan Bank and Shinhan Investment, respectively, for the year ended and as of December 31, 2014. For market risk management purposes, Shinhan Bank includes in the computation of total VaR its trading portfolio in bank accounts and assets in trust accounts, in each case, for which it guarantees principal or fixed return in accordance with the Financial Services Commission regulations.

	<b>Trading Portfolio VaR for the Year 2014</b>			
	<b>Average</b>	<b>Minimum</b>	<b>Maximum</b>	<b>As of December 31, 2014</b>
	<b>(In billions of Won)</b>			
<b>Shinhan Bank:<sup>(1)</sup></b>				
Interest rate	₩ 17.3	₩ 8.7	₩ 25.9	₩ 13.4
Foreign exchange <sup>(2)</sup>	43.9	34.9	54.4	49.4
Equities	4.3	2.5	7.4	3.4
Option volatility <sup>(3)</sup>	0.2	0.1	0.3	0.1
Less: portfolio diversification <sup>(4)</sup>	(18.7)	(5.2)	(32.3)	(13.3)
<b>Total VaR<sup>(5)</sup></b>	<b>₩ 47.0</b>	<b>₩ 41.0</b>	<b>₩ 55.5</b>	<b>₩ 53.0</b>
<b>Shinhan Investment:<sup>(1)</sup></b>				
Interest rate	₩ 9.00	₩ 3.51	₩ 30.06	₩ 6.07
Equities	7.53	3.39	14.68	14.44
Foreign exchange	3.69	0.65	17.35	5.23
Option volatility <sup>(3)</sup>	1.92	0.22	7.04	0.71

Less: portfolio diversification <sup>(4)</sup>	(7.73)	(1.40)	(38.17)	(8.97)
Total VaR	₩ 14.41	₩ 6.37	₩ 30.97	₩ 30.97

*Notes:*

- (1) Shinhan Bank and Shinhan Investment's ten-day VaR is based on a 99.9% confidence level.
- (2) Includes both trading and non-trading accounts as Shinhan Bank and Shinhan Investment manage foreign exchange risk on a total position basis.
- (3) Volatility implied from the option price using the Black-Scholes or a similar model.

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- (4) Calculation of portfolio diversification effects is conducted on different days scenarios for different risk components. Total VaRs are less than the simple sum of the risk component VaRs due to offsets resulting from portfolio diversification.
- (5) Includes trading portfolios in Shinhan Bank's bank accounts and assets in trust accounts, in each case, for which it guarantees principal or fixed return.

Shinhan Bank generally manages its market risk from the trading activities of its portfolios on an aggregated basis. To control its trading portfolio market risk, Shinhan Bank uses position limits, VaR limits, stop loss limits, Greek limits and stressed loss limits. In addition, it establishes separate limits for investment securities. Shinhan Bank maintains risk control and management guidelines for derivative trading based on the regulations and guidelines promulgated by the Financial Services Commission, and measures market risk from trading activities to monitor and control the risk of its operating divisions and teams that perform trading activities. Shinhan Bank manages VaR measurements and limits on a daily basis based on automatic interfacing of its trading positions into its market risk measurement system. In addition, Shinhan Bank presets limits on loss, sensitivity, investment and stress for its trading departments and desks and daily monitors such limits and observance thereof.

*Value-at-risk analysis.* Shinhan Bank uses ten-day and one-day VaRs to measure its market risk. Shinhan Bank calculates (i) ten-day VaRs on a daily basis based on data for the previous 12 months for the holding periods of ten days and (ii) one-day VaRs on a daily basis based on data for the previous 12 months for the holding periods of one day. A ten-day VaR and one-day VaR are statistically estimated maximum amounts of loss that can occur for ten days and one day, respectively, under normal market conditions. If a VaR is measured using a 99% confidence level, the actual amount of loss may exceed the expected VaR, on average, once out of every 100 business days, while if a VaR is measured using a 99.9% confidence level, the actual amount of loss may exceed the VaR, on average, once out of 1,000 business days.

Shinhan Bank currently uses the ten-day 99% confidence level-based VaR and stressed VaR for purposes of calculating the regulatory capital used in reporting to the Financial Supervisory Service. Stressed VaR reflects the potential significant loss in the current trading portfolio based on scenarios derived from a crisis simulation during the preceding 12 months. Shinhan Bank also uses the more conservative ten-day 99.9% confidence level-based VaR for purposes of calculating its economic capital used for internal management purposes, which is a concept used in determining the amount of Shinhan Bank's requisite capital in light of the market risk. In addition, Shinhan Bank uses the one-day 99% confidence level-based VaR on a supplemental basis for purposes of setting and managing risk limits specific to each desk or team in its operating units as well as for back-testing purposes. For Shinhan Bank, the actual amount of losses exceeded the one-day 99% confidence level-based VaR amount twice in 2013, by 23% on April 11, 2013 and by 73% on July 1, 2013, and once in 2014, by 58% on December 16, 2014.

Shinhan Investment currently uses the ten-day 99.9% confidence level-based historical VaR for purposes of calculating its economic capital used for internal management purposes. In addition, Shinhan Investment applies this VaR as a risk limit for the entire company as well as individual departments and products, and the adequacy of such VaR is reviewed by way of daily back-testing. When computing VaR, Shinhan Investment does not assume any particular probability distribution and calculates it through a simulation of the full valuation method based on changes of market variables such as stock prices, interest rates and foreign exchange rates in the past one year. For Shinhan Investment, the actual amount of losses did not exceed the one-day 99% confidence level-based VaR amount in 2013, but exceeded such amount three times in 2014, by 5%, 21% and 49% on August 28, 2014, September 11, 2014 and November 6, 2014, respectively.

Value-at-risk is a commonly used market risk management technique. However, VaR models have the following shortcomings:

VaR estimates possible losses over a certain period at a particular confidence level using past market movement data. Past market movement, however, is not necessarily a reliable indicator of future events, particularly those that are extreme in nature;



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VaR may underestimate the probability of extreme market movements;

Shinhan Bank's VaR models assume that a holding period of generally one to ten days is sufficient prior to liquidating the underlying positions, but such assumption regarding the length of the holding period may prove to be inadequate;

The 99.9% confidence level does not take into account or provide indication of any losses that might occur beyond this confidence level; and

VaR does not capture all complex effects of various risk factors on the value of positions and portfolios and could underestimate potential losses.

Currently, Shinhan Bank and Shinhan Investment conduct back-testing of VaR results against actual outcomes on a daily basis.

Shinhan Bank operates an integrated market risk management system which manages Shinhan Bank's Won-denominated and foreign-denominated accounts. This system uses historical simulation to measure both linear risks arising from products such as equity and debt securities and nonlinear risks arising from other products including options. We believe that this system enables Shinhan Bank to generate elaborate and consistent VaR information and to perform sensitivity analysis and back testing in order to check the validity of the models on a daily basis. Shinhan Life also measures market risks based on a VaR analysis.

*Stress test.* In addition to VaR, Shinhan Bank performs stress tests to measure market risk. As VaR assumes normal market situations, Shinhan Bank assesses its market risk exposure to unlikely abnormal market fluctuations through stress test. Stress test is a valuable supplement to VaR since VaR does not cover potential loss if the market moves in a manner that is outside Shinhan Bank's normal expectations. Stress test projects the anticipated change in value of holding positions under certain scenarios assuming that no action is taken during a stress event to change the risk profile of a portfolio.

Shinhan Bank uses seven relatively simple but fundamental scenarios for stress test by taking into account four market risk components: foreign currency exchange rates, stock prices, and Won-denominated interest rates and foreign currency-denominated interest rates. For the worst case scenario, Shinhan Bank assumes instantaneous and simultaneous movements in four market risk components: appreciation of Won by 20%, a decrease in Korea Exchange Composite Index by 30% and increases in Won-denominated and U.S. Dollar-denominated interest rates by 200 basis points each, respectively. Under this worst-case scenario, the market value of Shinhan Bank's trading portfolio would have declined by ₩317 billion as of December 31, 2014. Shinhan Bank performs stress test on a daily basis and reports the results to its Risk Policy Committee on a monthly basis and its Risk Management Committee on a quarterly basis.

Shinhan Investment uses nine scenarios for stress tests by taking into account four market risk components: stock prices (both in terms of stock market indices and  $\beta$ -based individual stock prices), interest rates for Won-denominated loans, foreign currency exchange rates and implied volatility. As of December 31, 2014, under the worst case scenario assuming a 1% point increase in the three-year government bond yield, the market value of Shinhan Investment's trading portfolio would have fluctuated by ₩39.6 billion for one day.

Shinhan Life Insurance conducts a stress test annually based on a bad scenario and a worst-case scenario, and the results of the stress test include expected losses and impacts on capital adequacy. Shinhan Life Insurance takes preemptive measures on the basis of the results from its stress tests.

Shinhan Bank sets limits on stress testing for its overall operations. Shinhan Investment sets limits on stress testing for its overall operations as well as at its department level. Although Shinhan Life Insurance does not set any limits on stress testing, it monitors the impact of market turmoil or any abnormality. In the case of Shinhan Bank, Shinhan Investment and Shinhan Life Insurance, if the potential impact is large, their respective Chief Risk Officer may request a portfolio restructuring or other proper action.

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### *Hedging and Derivative Market Risk*

The principal objective of our group-wide hedging strategy is to manage market risk within established limits. We use derivative instruments to hedge our market risk as well as to make profits by trading derivative products within preset risk limits. Our derivative trading includes interest rate and cross-currency swaps, foreign currency forwards and futures, stock index and interest rate futures, and stock index and currency options.

While we use derivatives for hedging purposes, derivative transactions by nature involve market risk since we take trading positions for the purpose of making profits. These activities consist primarily of the following:

arbitrage transactions to make profits from short-term discrepancies between the spot and derivative markets or within the derivative markets;

sales of tailor-made derivative products that meet various needs of our corporate customers, principally of Shinhan Bank and Shinhan Investment, and related transactions to reduce their exposure resulting from those sales;

taking positions in limited cases when we expect short-swing profits based on our market forecasts; and

trading to hedge our interest rate and foreign currency risk exposure as described above.

In relation to our adoption of IAS 39, *Financial Instruments: Recognition and Measurement*, we have implemented internal processes which include a number of key controls designed to ensure that fair value is measured appropriately, particularly where a fair value model is internally developed and used to price a significant product.

Shinhan Bank assesses the adequacy of the fair market value of a new product derived from its internal model prior to the launch of such product. The assessment process involves the following:

computation of an internal dealing system market value (based on assessment by the quantitative analysis team of the adequacy of the formula and the model used to compute the market value as derived from the dealing system);

computation of the market value as obtained from an outside credit evaluation company; and

following comparison of the market value derived from an internal dealing system to that obtained from outside credit evaluation companies, determination as to whether to use the internally developed market value based on inter-departmental consensus.

The dealing system market value, which is used officially by Shinhan Bank after undergoing the assessment process above, does not undergo a sampling process that confirms the value based on review of individual transactions, but is subject to an additional assessment procedure of comparing such value against the profits derived from the dealing

systems based on the deal portfolio sensitivity.

Shinhan Investment follows an internal policy as set by its Fair Value Evaluation Committee for computing and assessing the adequacy of fair value of all of its over-the-counter derivative products. Shinhan Investment computes the fair value based on an internal model and internal risk management systems and assesses the adequacy of the fair value through cross-departmental checks as well as comparison against fair values obtained from outside credit evaluation companies.

See Item 5.A. Operating Results Critical Accounting Policies and Note 3 of the notes to our consolidated financial statements.

Market risk from derivatives is not significant since derivative trading activities of Shinhan Bank and Shinhan Investment are primarily driven by arbitrage and customer deals with highly limited open trading positions. Market risk from derivatives is also not significant for Shinhan Life Insurance as its derivative trading activities are limited to those within preset risk limits and are subject to heavy regulations imposed on the insurance industry. Market risk from derivatives is not significant for our other subsidiaries since the amount of such positions by our other subsidiaries is insignificant.

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**Table of Contents*****Market Risk Management for Non-trading Activities******Interest Rate Risk***

Interest rate risk represents Shinhan Bank's principal market risk from non-trading activities. Interest rate risk is the risk of loss resulting from interest rate fluctuations that adversely affect the financial condition and results of operations of Shinhan Bank. Shinhan Bank's interest rate risk primarily relates to the differences between the timing of rate changes for interest-earning assets and that for interest-bearing liabilities.

Interest rate risk affects Shinhan Bank's earnings and the economic value of Shinhan Bank's net assets as follows:

*Earnings:* interest rate fluctuations have an effect on Shinhan Bank's net interest income by affecting its interest-sensitive operating income and expenses.

*Economic value of net assets:* interest rate fluctuations influence Shinhan Bank's net worth by affecting the present value of cash flows from the assets, liabilities and other transactions of Shinhan Bank.

Accordingly, Shinhan Bank measures and manages interest rate risk for non-trading activities by taking into account the effects of interest rate changes on both its income and net asset value. Shinhan Bank measures and manages interest rate risk on a daily and monthly basis with respect to all interest-earning assets and interest-bearing liabilities in Shinhan Bank's bank accounts (including derivatives denominated in Won which are principally interest rate swaps entered into for the purpose of hedging) and in trust accounts, except that Shinhan Bank measures VaRs on a monthly basis. Most of Shinhan Bank's interest-earning assets and interest-bearing liabilities are denominated in Won.

***Interest Rate Risk Management***

The principal objectives of Shinhan Bank's interest rate risk management are to generate stable net interest income and to protect Shinhan Bank's net asset value against interest rate fluctuations. Through its asset and liability management system, Shinhan Bank monitors and manages its interest rate risk based on various analytical measures such as interest rate gap, duration gap and net present value and net interest income simulations, and monitors on a monthly basis its interest rate VaR limits, interest rate earnings at risk (EaR) limits and interest rate gap ratio limits. Shinhan Bank measures its interest rate VaR and interest rate EaR based on simulated estimation of the maximum decrease in net asset value and net interest income in a one-year period based on various scenario analyses of historical interest rates. The Risk Policy Committee sets interest rate risk limits for Shinhan Bank's Won-denominated and foreign currency-denominated non-trading accounts and trust accounts, and the Risk Management Committee sets Shinhan Bank's overall interest rate risk, in both cases, at least annually. The Risk Management Department monitors Shinhan Bank's compliance with these limits and reports the monitoring results to the Risk Policy Committee on a monthly basis and the Risk Management Committee on a quarterly basis. Shinhan Bank uses interest rate swaps to control its interest rate exposure limits.

Interest rate VaR represents the maximum anticipated loss in a net present value calculation (computed as the present value of interest-earning assets minus the present value of interest-bearing liabilities), whereas interest rate EaR represents the maximum anticipated loss in a net earnings calculation (computed as interest income minus interest expenses) for the immediately following one-year period, in each case, as a result of negative movements in interest rates. Therefore, interest rate VaR is a more expansive concept than interest rate EaR in that the former covers all interest-earning assets and all interest-bearing liabilities, whereas the latter covers only those interest-earning assets

and interest-bearing liabilities that are exposed to interest rate volatility for a one-year period.

Hence, for interest rate VaRs, the duration gap (namely, the weighted average duration of all interest-earning assets minus the weighted average duration of all interest-bearing liabilities) can be a more critical factor than the relative sizes of the relevant assets and liabilities in influencing interest rate VaRs. In comparison, for

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interest rate EaRs, the relative sizes of the relevant assets and liabilities in the form of the one year or less interest rate gap (namely, the volume of interest-earning assets with maturities of less than one year minus the volume of interest-bearing liabilities with maturities of less than one year) is the most critical factor in influencing the interest rate EaRs.

The interest rate VaR limits are set as the sum of (i) the average of the monthly non-trading interest rate VARs as a percentage of interest-bearing assets over a period of one year and (ii) the standard deviation at the 99% confidence level (namely, 2.33 times the standard deviation of the monthly non-trading interest rate VARs as a percentage of interest-bearing assets).

The interest rate EaR limits are set at the maximum decrease in net interest income by (i) assuming that the estimated interest rate gap will expand to the maximum level of manageable (tolerable) situations and (ii) applying the interest rate shock scenario to the annual volatility of interest rates using past 10-year market interest rates.

On a monthly basis, we monitor whether the non-trading positions for interest rate VaR and EaR exceed their respective limits as described above.

Interest rate VaR cannot be meaningfully compared to the ten-day 99% confidence level based VaR ( market risk VaR ) for managing trading risk principally because (i) the underlying assets are different (namely, non-trading interest-bearing assets as well as liabilities in the case of the interest rate VaR, compared to trading assets only in the case of the market risk VaR), and (ii) interest rate VaR is sensitive to interest rate movements only while the market risk VaR is sensitive to interest rate movements as well as other factors such as foreign currency exchange rates, stock market prices and option volatility.

Even if comparison were to be made between the interest rate VaR and the interest rate portion only of the market risk VaR, we do not believe such comparison would be meaningful since the interest rate VaR examines the impact of interest rate movements on both assets and liabilities (which will likely have offsetting effects), whereas the interest rate portion of the market VaR examines the impact of interest rate movements on assets only.

Shinhan Bank uses various analytical methodologies to measure and manage its interest rate risk for non-trading activities on a daily and monthly basis, including the following analyses:

Interest rate gap analysis;

Duration gap analysis;

Market value analysis; and.

Net interest income simulation analysis.

*Interest Rate Gap Analysis*

Shinhan Bank performs an interest gap analysis to measure the difference between the amount of interest-earning assets and that of interest-bearing liabilities at each maturity and re-pricing date for specific time intervals by

preparing interest rate gap tables in which Shinhan Bank's interest-earning assets and interest-bearing liabilities are allocated to the applicable time intervals based on the expected cash flows and re-pricing dates.

On a daily basis, Shinhan Bank performs interest rate gap analysis for Won- and foreign currency-denominated assets and liabilities in its bank and trust accounts. Shinhan Bank's gap analysis includes Won-denominated derivatives (which are interest rate swaps for the purpose of hedging) and foreign currency-denominated derivatives (which are currency swaps for the purpose of hedging), which are managed centrally at



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the FX & Derivatives Department. Through the interest rate gap analysis that measures interest rate sensitivity gaps, cumulative gaps and gap ratios, Shinhan Bank assesses its exposure to future interest risk fluctuations. For interest rate gap analysis, Shinhan Bank assumes and uses the following maturities for different types of assets and liabilities:

with respect to the maturities and re-pricing dates of Shinhan Bank's assets, Shinhan Bank assumes that the maturity of Shinhan Bank's prime rate-linked loans is the same as that of its fixed-rate loans. Shinhan Bank excludes equity securities from interest-earning assets;

with respect to the maturities and re-pricing of Shinhan Bank's liabilities, Shinhan Bank assumes that money market deposit accounts and non-core demand deposits under the Financial Services Commission guidelines have a maturity of one month or less for both Won-denominated accounts and foreign currency-denominated accounts; and

with respect to core demand deposits under the Financial Services Commission guidelines, Shinhan Bank assumes that they have maturities of eight different intervals ranging from one month to five years.

The following tables show Shinhan Bank's interest rate gaps as of December 31, 2014 for (i) Won-denominated non-trading bank accounts, including derivatives entered into for the purpose of hedging and (ii) foreign currency-denominated non-trading bank accounts, including derivatives entered into for the purpose of hedging.

**Won-denominated non-trading bank accounts<sup>(1)</sup>**

	As of December 31, 2014						
	0-3 Months	3-6 Months	6-12 Months	1-2 Years	2-3 Years	Over 3 Years	Total
	(In billions of Won, except percentages)						
Interest-earning assets	₩ 101,077	₩ 46,100	₩ 9,662	₩ 11,025	₩ 11,221	₩ 17,664	₩ 196,749
Fixed rates	22,076	3,908	7,262	9,239	6,217	7,874	56,576
Floating rates	77,861	41,412	1,090	1,225	4,724	9,310	135,623
Interest rate swaps	1,140	780	1,310	560	280	480	4,550
Interest-bearing liabilities	₩ 86,329	₩ 30,414	₩ 42,006	₩ 13,136	₩ 8,103	₩ 14,608	₩ 194,595
Fixed liabilities	59,530	29,716	41,678	13,092	8,073	13,879	165,968
Floating liabilities	22,248	698	328	43	30	729	24,077
Interest rate swaps	4,550						4,550
Sensitivity gap	₩ 14,749	₩ 15,686	₩ (32,344)	₩ (2,111)	₩ 3,118	₩ 3,055	₩ 2,154
Cumulative gap	14,749	30,435	(1,909)	(4,020)	(902)	2,154	2,154
% of total assets	7.50%	15.47%	(0.97)%	(2.04)%	(0.46)%	1.09%	1.09%

**Foreign currency-denominated non-trading bank accounts<sup>(1)</sup>**

	As of December 31, 2014					Total
	0-3 Months	3-6 Months	6-12 Months	1-3 Years	Over 3 Years	
	(In millions of US\$, except percentages)					
Interest-earning assets	\$ 17,372	\$ 3,698	\$ 3,206	\$ 3,385	\$ 2,092	\$ 29,753
Interest-bearing liabilities	15,191	3,341	4,821	4,060	2,253	29,665
Sensitivity gap	2,181	357	(1,615)	(674)	(160)	88
Cumulative gap	2,181	2,538	923	249	88	88
% of total assets	7.33%	8.53%	3.10%	0.84%	0.30%	0.30%

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*Note:*

(1) Includes merchant banking accounts.

*Duration Gap Analysis*

Shinhan Bank performs a duration gap analysis to measure the differential effects of interest rate risk on the market value of its assets and liabilities by examining the difference between the durations of Shinhan Bank's interest-earning assets and those of its interest-bearing liabilities, which durations represent their respective weighted average maturities calculated based on their respective discounted cash flows using applicable yield curves. These measurements are done on a daily basis and for each operating department, account, product and currency, the respective durations of interest-earning assets and interest-bearing liabilities.

The following tables show duration gaps and market values of Shinhan Bank's Won-denominated interest-earning assets and interest-bearing liabilities in its non-trading accounts as of December 31, 2014 and changes in these market values when interest rate increases by one percentage point.

**Duration as of December 31, 2014 (for non-trading Won-denominated bank accounts<sup>(1)</sup>)**

	<b>Duration as of December 31, 2014</b> (In months)
Interest-earning assets	9.78
Interest-bearing liabilities	9.53
Gap	0.47

*Market Value Analysis*

Shinhan Bank performs a market value analysis to measure changes in the market value of Shinhan Bank's interest-earning assets compared to that of its interest-bearing liabilities based on the assumption of parallel shifts in interest rates. These measurements are done on a daily basis.

**Market Value as of December 31, 2014 (for non-trading Won-denominated bank accounts<sup>(1)</sup>)**

	<b>Market Value as of December 31, 2014</b> <b>1% Point</b>		
	<b>Actual</b>	<b>Increase</b>	<b>Changes</b>
	<b>(In billions of Won)</b>		
Interest-earning assets	₩ 200,675	₩ 199,134	₩ (1,541)
Interest-bearing liabilities	195,954	194,535	(1,419)
Gap	4,721	4,599	(122)

*Note:*

(1) Includes merchant banking accounts and derivatives for the purpose of hedging.

*Net Interest Income Simulation*

Shinhan Bank performs net interest income simulation to measure the effects of the change in interest rate on its results of operations. Such simulation uses deterministic analysis methodology to measure the estimated changes in Shinhan Bank's annual net interest income (interest income less interest expenses) under the current maturity structure, using different scenarios for interest rates (assuming parallel shifts) and funding requirements. For simulations involving interest rate changes, based on the assumption that there is no change in funding requirements, Shinhan Bank applies three scenarios of parallel shifts in interest rate: (1) no change, (2) a 1% point increase in interest rates and (3) a 1% point decrease in interest rates.

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The following table illustrates by way of an example the simulated changes in Shinhan Bank's annual net interest income for 2013 with respect to Won-denominated interest-earning assets and interest-bearing liabilities, using Shinhan Bank's net interest income simulation model, assuming (a) the maturity structure and funding requirement of Shinhan Bank as of December 31, 2013 and (b) the same interest rates as of December 31, 2014 and a 1% point increase or decrease in the interest rates.

**Simulated Net Interest Income for 2014**  
**(For Non-Trading Won-Denominated Bank Accounts<sup>(1)</sup>)**

	Assumed Interest Rates			Change in Net Interest Income		Change in Net Interest Income	
	No Change	1% Point Increase	1% Point Decrease	Amount (1% Point Increase)	% Change (1% Point Increase)	Amount (1% Point Decrease)	% Change (1% Point Decrease)
	(In billions of Won, except percentages)						
Simulated interest income	₩ 7,074	₩ 8,210	₩ 5,938	₩ 1,136	16.05%	₩ (1,136)	(16.05)%
Simulated interest expense	3,531	4,396	2,666	865	24.51%	(865)	(24.51)%
Net interest income	3,543	3,814	3,273	270	7.63%	(270)	(7.63)%

*Note:*

(1) Includes merchant banking accounts and derivatives entered into for the purpose of hedging. Shinhan Bank's Won-denominated interest-earning assets and interest-bearing liabilities in non-trading accounts have a maturity structure that benefits from an increase in interest rates, because the re-pricing periods for interest-earning assets in Shinhan Bank's non-trading accounts are, on average, shorter than those of the interest-bearing liabilities in these accounts. This is primarily due to a sustained low interest rate environment in the recent years in Korea, which resulted in a significant increase in demand for floating rate loans (which tend to have shorter maturities or re-pricing periods than fixed rate loans) as a portion of Shinhan Bank's overall loans, which in turn led to the shortening, on average, of the maturities or re-pricing periods of Shinhan Bank's loans on an aggregate basis. As a result, Shinhan Bank's net interest income tends to decrease during times of a decrease in the market interest rates while the opposite is generally true during times of an increase in the market interest rates.

*Interest Rate VaRs for Non-trading Assets and Liabilities*

Shinhan Bank measures VaRs for interest rate risk from non-trading activities on a monthly basis. The following table shows, as of and for the year ended December 31, 2014, the VaRs of interest rate mismatch risk for other assets and liabilities, which arises from mismatches between the re-pricing dates for Shinhan Bank's non-trading interest-earning assets including available-for-sale investment securities and those for its interest-bearing liabilities. Under the regulations of the Financial Services Commission, Shinhan Bank includes in calculation of these VaRs interest-earning assets and interest-bearing liabilities in its bank accounts and its merchant banking accounts.

		VaR for the Year 2014 <sup>(1)</sup>			As of December 31	
		Average	Minimum	Maximum		
		(In billions of Won)				
Interest rate mismatch	non-trading assets and liabilities	₩ 115	₩ 91	₩ 163	₩	163

*Note:*

(1) One-year VaR results with a 99.9% confidence level. Computed based on Shinhan Bank's internal model as explained below.

The foregoing VaR was computed based on Shinhan Bank's internal model, whereas the non-trading assets and liabilities VaR of Shinhan Bank appearing in note 4(c)(ii) to the financial statements included in this annual report was computed in accordance with the Basel Committee's proposed standard approach. In note 4(c)(ii) to

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the financial statements, we did not use the internal model but instead used the Basel Committee's proposed standard approach because in such note we presented non-trading assets and liabilities VaRs also for our other subsidiaries (namely, Shinhan Card, Shinhan Investment and Shinhan Life Insurance) and we currently do not apply the internal model to Shinhan Investment (although we are in the process of developing an internal model for Shinhan Investment as well for target completion by the end of 2015). In addition, Shinhan Bank is required to report to domestic regulators non-trading assets and liabilities VaR prepared based on both the Basel Committee's proposed standard approach and our internal model. Therefore, in order to enhance comparability across our subsidiaries appearing in note 4(c)(ii) to the financial statements, as well as with the reports submitted to the Korean regulators, we applied the Basel Committee's proposed standard approach for purposes of the disclosure in note 4(c)(ii) to the financial statements.

Under our internal model, non-trading assets and liabilities VaR is computed based on historical simulation at the 99.9% confidence level, namely by computing the average net present value based on the net present value distribution under historical interest rate scenarios and subtracting from such average net present value the net present value at the 0.1% percentile. In comparison, under the Basel Committee's proposed standard approach, non-trading assets and liabilities VaR is computed by using the following formula involving the interest rate gap under different maturity time buckets, the modified duration proxy as proposed by the Basel Committee and the standard interest rate shock of 200 basis points:

$$\text{Interest rate VaR} = [\text{Interest rate gap for maturity } i * \text{Modified duration proxy of maturity } i] * 200 \text{ basis points}$$

where:

*Maturity i* is 0 to 1 month, 1 to 3 months, 3 to 6 months, 6 to 12 months, 1 to 2 years, 2 to 3 years, 3 to 4 years, 4 to 5 years, 5 to 7 years, 7 to 10 years, 10 to 15 years, 15 to 20 years and more than 20 years;

*Interest rate gap* means the difference between the amount of interest sensitive assets and the amount of interest sensitive liabilities for each maturity time bucket, which is classified based on the respective interest rate reset dates (namely, (i) in the case of floating rate loans, the periodic interest rate determination dates and (ii) in the case of fixed rate loans, the interest rate reset dates, if any, or the maturity date (in the case of rollovers)); and

*Modified duration proxy* means the sensitivity in bond prices relating to movements in interest rates, which may substitute for interest rate gap for maturity *i* to calculate interest rate VaR under the standardized guidelines proposed by the Basel Committee.

Upon completion of the development and testing of the internal model for Shinhan Investment as currently expected by the end of 2015, in the corresponding note to the financial statements in future annual reports, we plan to present the VaR for interest rate risk from non-trading activities of Shinhan Bank, Shinhan Card, Shinhan Investment and Shinhan Life Insurance each based our internal model rather than based on the current mix of internal model and Basel Committee's proposed standard approach as currently disclosed, for purposes of enhanced comparability and consistency.

*Interest Rate Risk for Other Subsidiaries*

Shinhan Card monitors and manages its interest rate risk for all its interest-bearing assets and liabilities (including off-balance sheet items) in terms of the impact on its earnings and net asset value from changes in interest rates. Shinhan Card primarily uses interest rate VaR and EaR analyses to measure its interest rate risk.

The interest rate VaR analysis used by Shinhan Card principally focuses on the maximum impact on its net asset value from adverse movements in interest rates and consists of (i) historical interest rate VaR analysis and (ii) interest rate gap analysis. The historical interest rate VaR analysis is made through simulation of net asset value based on the interest rate volatility over a fixed past period to produce expected future interest rate scenarios and computes the maximum value at risk at a 99.9% confidence level by analyzing the net present



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value distribution under each such scenario. As for interest rate gap analysis, Shinhan Card computes the value at risk based on the duration proxies and interest rate shocks for each time interval as recommended under the Basel Accord.

The interest rate EaR analysis used by Shinhan Card computes the maximum loss in net interest income for a one-year period following adverse movements in interest rates, based on an interest rate gap analysis using the time intervals and the middle of time band as recommended under the Basel Accord.

Shinhan Life Insurance monitors and manages its interest rate risk for its investment assets and liabilities based on simulations of its asset-liability management system. These simulations typically involve subjecting Shinhan Life Insurance's current and future assets and liabilities to more than 2,000 market scenarios based on varying assumptions, such as new debt purchases and target investment portfolios, so as to derive its net asset value forecast for the next three years at a 99% confidence level.

Interest rate risk for our other subsidiaries is insignificant.

*Equity Risk*

Substantially all of Shinhan Bank's equity risk relates to its portfolio of common stock in Korean companies. As of December 31, 2014, Shinhan Bank held an aggregate amount of ₩169 billion of equity interest in unlisted foreign companies (including ₩98 billion invested in unlisted private equity funds).

The equity securities in Won held in Shinhan Bank's investment portfolio consist of stocks listed on the KRX KOSPI Market or the KRX KOSDAQ Market of the Korea Exchange and certain non-listed stocks. Shinhan Bank sets exposure limits for most of these equity securities to manage their related risk. As of December 31, 2014, Shinhan Bank held equity securities in an aggregate amount of ₩2,068 billion in its non-trading accounts, including equity securities in the amount of ₩419 billion that it held, among other reasons, for management control purposes and as a result of debt-to-equity conversion as a part of reorganization proceedings of the companies to which it had extended loans.

As of December 31, 2014, Shinhan Bank held Won-denominated convertible bonds in an aggregate amount of ₩46 billion and Won-denominated bonds with warrants in an aggregate amount of ₩1.9 billion, in each case, in its non-trading accounts. Shinhan Bank does not measure equity risk with respect to convertible bonds or bonds with warrants and the interest rate risk of these equity-linked securities are measured together with the other debt securities. As such, Shinhan Bank measures interest rate risk VaRs but not equity risk VaRs for these equity-linked securities.

*Liquidity Risk Management*

Liquidity risk is the risk of insolvency, default or loss due to disparity between inflow and outflow of funds, including the risk of having to obtain funds at a high price or to dispose of securities at an unfavorable price due to lack of available funds. Each of our subsidiaries seeks to minimize liquidity risk through early detection of risk factors related to the sourcing and managing of funds that may cause volatility in liquidity and by ensuring that it maintains an appropriate level of liquidity through systematic management. At the group-wide level, we manage our liquidity risk by conducting monthly stress tests that compare liquidity requirements under normal situations against those under three types of stress situations, namely, our group-specific internal crisis, crisis in the external market and a combination of internal and external crisis. In addition, in order to preemptively and comprehensively manage liquidity risk, we measure and monitor liquidity risk management using various indices, including the limit management index, early warning index and monitoring index.

Shinhan Bank applies the following basic principles for liquidity risk management:

raise funds in sufficient amounts, at the optimal time at reasonable costs;

maintain liquidity risk at appropriate levels and preemptively manage them through a prescribed risk limit system and an early warning signal detection system;

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secure stable sources of revenue and minimize actual losses by implementing an effective asset-liability management system based on diversified sources of funding with varying maturities;

monitor and manage daily and intra-daily liquidity positions and risk exposures for timely payment and settlement of financial obligations due under both normal and crisis situations;

conduct periodic contingency analysis in anticipation of any potential liquidity crisis and establish and implement emergency plans in case of an actual crisis; and

consider liquidity-related costs, benefits of and risks in determining the pricing of our products and services, employee performance evaluations and approval of launching of new products and services.

Each of our subsidiaries manages liquidity risk in accordance with the risk limits and guidelines established internally as well as by the relevant regulatory authorities. Pursuant to principal regulations applicable to financial holding companies and banks as promulgated by the Financial Services Commission, we, at the holding company level, are required to maintain specific Won and foreign currency liquidity ratios. These ratios require us to maintain the ratio of liquid assets to liquid liabilities above certain minimum levels.

Shinhan Bank manages its liquidity risk within the limits set on Won and foreign currency accounts in accordance with the regulations of the Financial Services Commission. The Financial Services Commission requires Korean banks to maintain a Won liquidity ratio of at least 100.0% and a foreign currency liquidity ratio of at least 85.0%. The Financial Services Commission defines the foreign currency liquidity ratio as foreign currency-denominated liquid assets (including marketable securities) divided by foreign currency-denominated liabilities, in each case, due within three months. As for the Won liquidity ratio, the Financial Services Commission defines it as all Won-denominated assets divided by all Won-denominated liabilities, in each case, that are on the balance sheet or arise from off-balance sheet derivative transactions with outstanding maturities of less than one month, except that (i) Won-denominated trading and available-for-sale securities with outstanding maturities of one month or more are included as Won liquid assets at their fair market value to the extent that such securities are marketable and have not been provided as collateral, and (ii) Won-denominated demand deposits with no fixed maturity are included as Won liquid liabilities in an amount equal to the sum of (x) the standard deviation of the monthly weighted average balance during the preceding 12-month period multiplied by 2.33 (such product, the non-core deposits) and (y) 15% of core deposit (meaning the monthly average balance of the most recent month prior to the time of determination), less the non-core deposits.

The monthly weighted average balance for the preceding 12-month period is calculated using the following formula:

The standard deviation of the monthly weighted average balance during the preceding 12-month period is calculated using the following formula:



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The weighed period coefficients for the applicable month are set forth below:

Applicable Month	Weighed Period Coefficient
t-11 month	1/78
t-10 month	2/78
t-9 month	3/78
t-8 month	4/78
t-7 month	5/78
t-6 month	6/78
t-5 month	7/78
t-4 month	8/78
t-3 month	9/78
t-2 month	10/78
t-1 month	11/78
t month	12/78
<b>Sum</b>	<b>1</b>

With respect to Won-denominated demand deposits with no fixed maturity, given that a portion of the balance of such demand deposits may be withdrawn at any time, we categorize them as core deposits and non-core deposits each as defined above.

The following tables show Shinhan Bank's liquidity status and limits for Won-denominated accounts (including derivatives and merchant banking accounts), together with a breakdown of their respective components, as of December 31, 2014 in accordance with the regulations of the Financial Services Commission.

**Shinhan Bank's Won-denominated accounts (including derivatives and merchant banking accounts)**

Won-Denominated Accounts	0-1	1-3	3-6	6-12	1-3	Over 3	Substandard	Total
	Months	Months	Months	Months	Years	Years	or Below	
(In billions of Won, except percentages)								
Assets:	₩ 55,338	₩ 19,938	₩ 31,611	₩ 49,129	₩ 30,145	₩ 51,924	₩ 1,746	₩ 239,831
Cash and deposit	10,551	100	100					10,751
Available-for-sale securities	26,217					3,722	84	30,023
Loans	8,869	15,436	27,672	44,108	25,544	40,951	1,662	164,241
Other assets	3,607					5,673		9,280
Derivative assets	3,389	4,147	3,500	4,021	4,384	1,139		20,580
Merchant banking account assets	2,706	256	339	1,000	217	439		4,957
Liabilities:	45,259	24,236	29,102	43,808	15,505	59,869		217,779
Deposits (including certificates of deposit)	28,531	19,273	23,927	36,531	5,965	49,477		163,703
Borrowings	3,050	290	88	142	608	1,913		6,090
Debt securities	122	620	2,084	2,960	4,520	2,233		12,540

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Other liabilities	6,289					3,955	10,244
Derivatives liabilities	3,542	4,054	3,003	4,175	4,412	1,092	20,278
Merchant banking account liabilities	3,724					1,199	4,924
Liquidity gap	10,080						
Liquidity ratio	122.27%						
Limit	100%						

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The breakdown of financial instruments by contractual maturities for purposes of analyzing liquidity risk as set forth in Note 4 to the consolidated financial statements was prepared based on the relevant line items presented in Shinhan Bank's statement of financial position. In comparison, the breakdown of financial instruments by contractual maturities for purposes of analyzing liquidity gap as set forth above was prepared based on the Banking Regulations promulgated by the Financial Services Commission.

For the most part, the criteria used for determining the remaining maturities on these two sections are the same, the primary exception being in respect of demand deposits. Under IFRS, all demand deposits are categorized as having maturities of less than one month; however, under the Banking Regulations, demand deposits are categorized as having maturities of less than one month in an amount equal to the sum of (x) the non-core deposits and (y) 15% of core deposits. Shinhan Bank's total demand deposit balance as of December 31, 2014 was ₩62,085 billion of which ₩55,866 billion was classified as core deposits and ₩14,736 billion was classified as Won liquid liabilities (namely, liabilities with maturities of less than one month based on the formula under the Banking Regulations).

Shinhan Bank's Treasury Department is in charge of liquidity risk management with respect to Shinhan Bank's Won and foreign currency funds. The Treasury Department submits Shinhan Bank's monthly funding and asset management plans to Shinhan Bank's Asset and Liability Committee for approval, based on the analysis of various factors, including macroeconomic indices, interest rate and foreign exchange movements and maturity structures of Shinhan Bank's assets and liabilities. Shinhan Bank's Risk Management Department measures Shinhan Bank's liquidity ratio and liquidity gap ratio on a daily basis and reports on a monthly basis whether they are in compliance with the limits to Shinhan Bank's Risk Policy Committee, which sets and monitors Shinhan Bank's liquidity ratio and liquidity gap ratio.

The following tables show Shinhan Bank's liquidity status and limits for foreign currency-denominated accounts (including derivatives and merchant banking accounts) as of December 31, 2014 in accordance with the regulations of the Financial Services Commission.

**Shinhan Bank's foreign currency-denominated accounts (including derivatives and merchant banking accounts)**

As of December 31, 2014								
Foreign Currency Denominated Accounts:	7 Days or Less	1 Month or Less	3 Months or Less	6 Months or Less	12 Months or Less	Total	Sub-	Total
						Before Sub-Standard or Below <sup>(1)</sup>	Standard or Below	
(In millions of US\$, except percentages)								
Assets:	\$ 8,259	\$ 15,285	\$ 25,309	\$ 34,587	\$ 42,735	\$ 52,795	\$ 93	\$ 52,888
Liabilities	5,838	11,388	19,473	26,310	36,437	52,198		52,198
For three months or less:								
Assets			25,309					
Liabilities			19,473					
Liquidity ratio			129.97%					
Limit			85.00%					

Note:

- (1) Cumulative total of accounts, including accounts over one year, but excluding accounts that are sub-standard or below.

Shinhan Bank maintains diverse sources of liquidity to facilitate flexibility in meeting its funding requirements. Shinhan Bank funds its operations principally by accepting deposits from retail and corporate depositors, accessing the call loan market (a short-term market for loans with maturities of less than one month), issuing debentures and borrowing from the Bank of Korea. Shinhan Bank uses the funds primarily to extend loans or purchase securities. Generally, deposits are of shorter average maturity than loans or investments.



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Shinhan Card manages its liquidity risk according to the following principles: (i) provide a sufficient volume of necessary funding in a timely manner at a reasonable cost, (ii) establish an overall liquidity risk management strategy, including in respect of liquidity management targets, policy and internal control systems, and (iii) manage its liquidity risk in conjunction with other risks based on a comprehensive understanding of the interaction among the various risks. As for any potential liquidity shortage at or near the end of each month, Shinhan Card maintains liquidity at a level sufficient to withstand credit shortage for three months.

In addition, Shinhan Card manages liquidity risk by setting and complying with specific guidelines for various measures of liquidity, including the breakdown of contractual payment obligations by maturity, overseas funding, the ratio of asset-backed securitized borrowings to the total borrowing, the ratio of requisite liquidity to reserve liquidity, and the ratio of fixed interest rate borrowings to floating interest rate borrowings. Furthermore, Shinhan Card closely monitors various indicators of a potential liquidity crisis, such as the actual liquidity gap ratio (in relation to the different maturities for assets as compared to liabilities), the liquidity buffer ratio. Shinhan Card also has contingency plans in place in case of any emergency or crisis. In managing its liquidity risk, Shinhan Card focuses on a prompt response system based on periodic monitoring of the relevant early signals, stress testing and contingency plan formulations. Shinhan Card identifies its funding needs on a daily, monthly, quarterly and annual basis based on the maturity schedule of its liabilities as well as short-term liquidity needs, based upon which it formulates its funding plans using diverse sources such as corporate debentures, commercial papers, asset-backed securitizations and credit line facilities. When entering into asset-backed securitizations, Shinhan Card provides sufficient credit enhancements to avoid triggering early amortization events. In addition, prior to entering into any funding transaction and related derivative transaction, Shinhan Card conducts pre-transaction risk analyses, including in respect of counterparty credit risk and its total exposure limit by country and by financial institution.

Shinhan Card also manages its liquidity risk within the limits set on Won accounts in accordance with the regulations of the Financial Services Commission. Under the Specialized Credit Financial Business Act and the regulations thereunder, credit card companies in Korea are required to maintain a Won liquidity ratio of at least 100.0%.

The following tables show Shinhan Card's liquidity status and limits for Won-denominated accounts as of December 31, 2014 in accordance with the regulations of the Financial Services Commission.

**Shinhan Card's Won-denominated accounts**

Won-Denominated Accounts	7 Days or 1 Month		or 3 Months or 6 Months		1 Year	Over	Total
	Less	Less	Less	Less	Less	1 Year	
(In billions of Won, except percentages)							
Assets	₩ 2,249	₩ 9,959	₩ 14,584	₩ 16,822	₩ 19,009	₩ 3,463	₩ 22,472
Liabilities	683	2,752	3,014	4,196	6,298	16,672	22,970
Liquidity ratio	483.79%						

Shinhan Investment manages its liquidity risk for its Won-denominated accounts by setting a limit of ₩100 billion on each of its seven-day and one-month liquidity gap, a limit of 110% on its three-months liquidity ratio and a limit of ₩8 billion on its liquidity VaR. As for its foreign currency-denominated accounts, Shinhan Investment manages the liquidity risk on a quarterly basis in compliance with the guidelines of the Financial Supervisory Service, which requires the one-week and one-month maturity mismatch ratios to be 0% and -10% or less, respectively, and the three months liquidity ratio to be 80% or higher.

Our other subsidiaries fund their operations primarily through call money, bank loans, commercial paper, corporate debentures and asset-backed securities. Our holding company acts as a funding vehicle for long-term financing of our subsidiaries whose credit ratings are lower than the holding company, including Shinhan Card and Shinhan Capital, to lower the overall funding costs within regulatory limitations. Under the Monopoly Regulation and Fair Trade Act of Korea, however, a financial holding company is prohibited from borrowing funds in excess of 200% of its total stockholders' equity.

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In addition to liquidity risk management under the normal market situations, we have contingency plans to effectively cope with possible liquidity crisis. Liquidity crisis arises when we would not be able to effectively manage the situations with our normal liquidity management measures due to, among other reasons, inability to access our normal sources of funds or epidemic withdrawals of deposits as a result of various external or internal factors, including a collapse in the financial markets or abrupt deterioration of our credit. We have contingency plans corresponding to different stages of liquidity crisis: namely, alert stage, imminent-crisis stage and crisis stage, based on the following liquidity indices:

indices that reflect the market movements such as interest rates and stock prices;

indices that reflect financial market sentiments, an example being the size of money market funds; and

indices that reflect our internal liquidity condition.

*Operational Risk Management*

Operational risk is difficult to quantify and subject to different definitions. The Basel Committee defines operational risk as the risk of loss resulting from inadequate or failed internal processes, people and systems or from other external events. Similarly, we define operational risk as the risks related to our overall management other than credit risk, market risk, interest rate risk and liquidity risk. These include risks arising from system failure, human error, non-adherence to policy and procedures, fraud, inadequate internal controls and procedures or environmental changes and resulting in financial and non-financial loss. We monitor and assess operational risks related to our business operations, including administrative risk, information technology risk (including cyber security risk), managerial risk and legal risk, with a view to minimizing such losses.

Our holding company's Audit Committee, which consists of four outside directors, two of whom are accounting or financial experts as required by internal control regulations under the Financial Holding Company Act, oversees and monitors our operational compliance with legal and regulatory requirements. The Audit Committee also oversees management's operations and may, at any time it deems appropriate, demand additional operations-related reporting from management and inspects our asset condition. At the holding company level, we define each subsidiary's operational process and establish an internal review system applicable to each subsidiary. Each subsidiary's operational risk is internally monitored and managed at the subsidiary level and the Group Internal Audit Department at our holding company, which reports to our Audit Committee, continuously monitors the integrity of our subsidiaries' operational risk management system. Our holding company's board of directors and the Group Risk Management Committee establish our basic policies for operational risk management at the group level. The Group Internal Audit Department at our holding company is directly responsible for overseeing our operational risk management with a focus on legal, regulatory, operational and reputational risks. The Group Internal Audit Department audits both our and our subsidiaries' operations and asset condition in accordance to our annual audit plan, which is approved by the Audit Committee, and submits regular reports to the Audit Committee pursuant to our internal reporting system. If the Group Internal Audit Department discovers any non-compliance with operational risk procedures or areas of weaknesses, it promptly alerts the business department in respect of which such non-compliance was discovered and demands implementation of corrective measures. Implementation of such corrective measures is subsequently reviewed by the Group Internal Audit Department.

To monitor and manage operational risks, Shinhan Bank maintains a system of comprehensive policies and has in place a control framework designed to provide a stable and well-managed operational environment throughout the organization. Currently, the primary responsibility for ensuring compliance with our banking operational risk procedures remains with each of the business units and operational teams. In addition, the Audit Department, the Risk Management Department and the Compliance Department of Shinhan Bank also play important roles in reviewing and maintaining the integrity of Shinhan Bank's internal control environment.

The operational risk management system of Shinhan Bank is managed by the operational risk team under the Risk Management Department. The current system principally consists of risk control self-assessment, risk quantification using key risk indicators, loss data collection, scenario management and operational risk capital

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measurement. Shinhan Bank operates several educational and awareness programs designed to have all of its employees to be familiar with this system. In addition, Shinhan Bank has a designated operational risk manager at each of its departments and branch offices, who serves as a coordinator between the operational risk team at the headquarters and the employees in the front office and seeking to provide centralized feedback to further improve the operational risk management system.

As of December 31, 2014, Shinhan Bank has conducted risk control self-assessments on its departments as well as domestic and overseas branch offices, from which it collects systematized data on all of its branch offices, and uses the findings from such self-assessments to improve the procedures and processes for the relevant departments or branch offices. In addition, Shinhan Bank has accumulated risk-related data since 2003, improved the procedures for monitoring operational losses and is developing risk simulation models. In addition, Shinhan Bank selects and monitors, at the department level, approximately 196 key risk indicators.

The audit committee of Shinhan Bank, which consists of three outside directors, is an independent inspection authority that supervises Shinhan Bank's internal controls and compliance with established ethical and legal principles. The audit committee performs internal audits of, among other matters, Shinhan Bank's overall management and accounting, and supervises its Audit Department that assists Shinhan Bank's audit committee. Shinhan Bank's audit committee also reviews and evaluates Shinhan Bank's accounting policies and their changes, financial and accounting matters and fairness of financial reporting.

Shinhan Bank's Audit Committee and Audit Department supervise and perform the following audits:

general audits, including full-scale audits performed annually for the overall operations, sectional audits of selected operations performed as needed, and periodic and irregular spot audits;

special audits, performed when the Audit Committee or standing auditor deems it necessary or pursuant to requests by the chief executive officer or supervisory authorities such as the Financial Supervisory Service;

day-to-day audits, performed by the standing auditor for material transactions or operations that are subject to approval by the heads of Shinhan Bank's operational departments or senior executives;

real-time monitoring audits, performed by the computerized audit system to identify any irregular transactions and take any necessary actions; and

self-audits as a self-check by each operational department to ensure its compliance with our business regulations and policies, which include daily audits, monthly audits and special audits.

In addition to these audits and compliance activities, Shinhan Bank's Audit Department designates operational risk management examiners to monitor the appropriateness of operational risk management frameworks and the functions and activities of the board of directors, relevant departments and business units, and conducts periodic checks on the operational risk and reports such findings. Shinhan Bank's Audit Department also reviews in advance proposed banking products or other business or service plans with a view to minimizing operational risk.

As for Shinhan Investment, its audit department conducts an annual inspection as to whether the internal policy and procedures of Shinhan Investment relating to its overall operational risk management are being effectively complied. The inspection has a particular focus on the appropriateness of the scope of operational risks and the collection, maintenance and processing of relevant operating data. Shinhan Investment, through its operational risk management system, also conducts self-assessments of risks, collects loss data and manages key risk indicators. The operational risk management system is supervised by its audit department, compliance department and operational risk management department, as well as a risk management officer in each of Shinhan Investment's departments.

General audits, special audits, day-to-day audits and real-time monitoring audits are performed by our examiners, and self-audits are performed by the self-auditors of the relevant operational departments.

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In addition to internal audits and inspections, the Financial Supervisory Service conducts general annual audits of our and our subsidiaries' operations. The Financial Supervisory Service also performs special audits as the need arises on particular aspects of our and our subsidiaries' operations such as risk management, credit monitoring and liquidity. In the ordinary course of these audits, the Financial Supervisory Service routinely issues warning notices where it determines that a regulated financial institution or such institution's employees have failed to comply with the applicable laws or rules, regulations and guidelines of the Financial Supervisory Service. We and our subsidiaries have in the past received, and expect in the future to receive, such notices and we have taken and will continue to take appropriate actions in response to such notices. For example, in July 2012, the Financial Supervisory Service issued an institutional warning in relation to an embezzlement case involving Dongah on the grounds that there were misconduct in payment of funds held in the trust account and mismanagement of internal control. For detailed description of the Dongah case, please see Item 8.A. Consolidated Statements and Other Financial Information – Legal Proceedings.

The Financial Supervisory Service conducted a comprehensive audit of Shinhan Bank from November to December 2012, and in July 2013, notified Shinhan Bank of an institutional caution, imposed disciplinary actions against 65 Shinhan Bank employees and assessed a fine of ₩87.5 million after finding that Shinhan Bank had illegally monitored customer accounts, breached confidentiality with respect to certain financial transactions and violated its obligation to disclose and report an investment in an affiliated company to the Financial Services Commission. Furthermore, in March 2013 the Financial Supervisory Service conducted a special audit of Shinhan Bank as to an alleged malfunctioning of its financial computer network and in December 2013, notified Shinhan Bank of an institutional caution and imposed disciplinary actions against five Shinhan Bank employees after finding that Shinhan Bank did not properly maintain its information technology administrator account and vaccine server.

The Financial Supervisory Service also conducted a special audit of Shinhan Card, together with BC Card and KB Kookmin Card, from June to July 2013, in relation to alleged imperfect sales of insurance products, and in March 2014, issued an institutional warning against each of the three credit card companies based on a finding that card customers were provided inadequate or misleading disclosures regarding the risks relating to such products at the time of sale. The Financial Supervisory Service also imposed disciplinary actions against three Shinhan Card employees and assessed a fine of ₩10 million against Shinhan Card as well as similar sanctions against BC Card and KB Kookmin Card. In December 2014, the Financial Supervisory Service also issued institutional cautions against Shinhan Life for selling insurance products without adequate disclosure and for incomplete payments of agency fees, together with a fine of ₩338 million in relation to the former case.

We consider legal risk as a part of operational risk. The uncertainty of the enforceability of obligations of our customers and counterparties, including foreclosure on collateral, creates legal risk. Changes in laws and regulations could also adversely affect us. Legal risk is higher in new areas of business where the law is often untested in the courts although legal risk can also increase in our traditional business to the extent that the legal and regulatory landscape in Korea changes and many new laws and regulations governing the banking industry remain untested. We seek to minimize legal risk by using stringent legal documentation, employing procedures designed to ensure that transactions are properly authorized and consulting legal advisers. The Compliance Department operates Shinhan Financial Group's compliance system. This system is designed to ensure that all employees of Shinhan Financial Group and its subsidiaries comply with the relevant laws and regulations. The compliance system's main function is to monitor the degree of improvement in compliance with the relevant laws and regulations, maintain internal controls (including ensuring that each department has established proper internal policies and that it complies with those policies) and educate employees about observance of the relevant laws and regulations. The Compliance Department also supervises the management, execution and performance of self-audits.

*Upgrades of Risk Management System*

Our recent material upgrades in relation to risk management systems are as follows.



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### *Shinhan Bank*

In order to strengthen risk management of its overseas subsidiaries and effectively comply with local and domestic regulations, Shinhan Bank is in the process of laying out a global risk management system network, which records the risk data of its overseas subsidiaries. Shinhan Bank seeks to leverage the development of this system for further overseas expansion and stable growth of existing overseas subsidiaries. To-date, Shinhan Bank has completed the development of such system for its subsidiaries in China, Japan, Vietnam, the United States, Canada and India and plans to expand the application of this system to its other overseas subsidiaries.

Shinhan Bank has also completed development of a system to calculate stressed VaR based on Basel II standards in order to prepare for stress situations such as the global financial crisis in 2008. Shinhan Bank has received approval for such system from the Financial Supervisory Service and has been implemented since 2012.

In 2012, Shinhan Bank developed a system for improving collection and recovery of bad assets through enhanced loss given default ( LGD ) data processing. In addition, in 2012, Shinhan Bank received approvals from the Financial Supervisory Service for upgrades to its credit evaluation modeling for risk assessment of small- to medium-sized enterprises that are not required to be audited by outside accounting firms and for SOHOs, which upgrades related to accounting for in the credit profiles of the heads of such enterprises and SOHOs. In addition, in 2013, Shinhan Bank obtained approval from the Financial Supervisory Service to use an internal evaluation model with respect to Basel II credit risks related to Shinhan Bank's retail SOHO exposures. In 2014, Shinhan Bank further upgraded the credit evaluation modeling for risk assessment of small- and medium-size enterprises that are not required to be audited by outside accounting firms by entirely revamping the modeling for enterprises subject to outside audits, enterprises that are not subject to outside auditors and enterprise heads. Such upgraded modeling was approved by the Financial Supervisory Service and Shinhan Bank began implementation of the upgraded system since 2014.

Shinhan Bank also upgraded the asset and liability management system in 2012 in order to timely comply with Basel III, IFRS and other regulatory requirements as well as to upgrade the quality of risk-related data. In 2014, Shinhan Bank upgraded the liquidity coverage ratio and net stable funding ratio systems under Basel III in order to facilitate daily measurement and efficient management.

Following the approval by the Financial Supervisory Service of the advanced measurement approach for risk management, Shinhan Bank has re-established the operational risk management system in order to further enhance its operational risk management capabilities.

### *Shinhan Card*

In 2012, Shinhan Card completed further upgrades to its credit risk measurement system in satisfaction of the Basel II standards, as well as other regulatory requirements and internal needs in order to address the ongoing volatility in the economic and regulatory environment.

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**Supervision and Regulation**

**Principal Regulations Applicable to Financial Holding Companies**

***General***

The Korean financial holding companies and their subsidiaries are regulated by the Financial Holding Companies Act (last amended on May 28, 2014, Law No. 10361). In addition, Korean financial holding companies and their subsidiaries are subject to the regulations and supervision of the Financial Services Commission and the Financial Supervisory Service.

Pursuant to the Financial Holding Companies Act, the Financial Services Commission regulates various activities of financial holding companies. For instance, it approves the application for setting up a new financial holding company and promulgates regulations on the capital adequacy of financial holding companies and their subsidiaries and other regulations relating to the supervision of financial holding companies.

The Financial Supervisory Service is subject to the instructions and directives of the Financial Services Commission and carries out supervision and examination of financial holding companies and their subsidiaries. In particular, the Financial Supervisory Service sets forth liquidity and capital adequacy requirements for financial holding companies and reporting requirements pursuant to the authority delegated to the Financial Supervisory Service under the Financial Services Commission regulations, pursuant to which financial holding companies are required to submit quarterly reports on business performance, financial status and other matters prescribed in the Presidential Decree of the Financial Holding Companies Act.

Under the Financial Holding Companies Act, the establishment of a financial holding company must be approved by the Financial Services Commission. A financial holding company is required to be mainly engaged in controlling its subsidiaries by holding the shares or equities of the subsidiaries in the amount of not less than 50% of aggregate amount of such financial holding company's assets based on the latest balance sheet. A financial holding company is prohibited from engaging in any profit-making businesses other than controlling the management of its subsidiaries and certain ancillary businesses as prescribed in the Presidential Decree of the Financial Holding Companies Act which include the following businesses:

financially supporting its subsidiaries and the subsidiaries of its subsidiaries (the direct and indirect subsidiaries);

raising capital necessary for the investment in subsidiaries or providing financial support to its direct and indirect subsidiaries;

supporting the business of its direct and indirect subsidiaries for the joint development and marketing of new product and the joint utilization of facilities or IT systems; and

pursuing any other activities exempted from authorization, permission or approval under the applicable laws and regulations.

The Financial Holding Companies Act requires every financial holding company (other than any financial holding company that is controlled by any other financial holding company) or its subsidiaries to obtain the prior approval from the Financial Services Commission before acquiring control of another company or to file with the Financial Services Commission a report within thirty days after acquiring such control. Permission to liquidate or to merge with any other company must be obtained in advance from the Financial Services Commission. A financial holding company must report to the Financial Services Commission regarding certain events including:

when there is a change of its officers;

when there is a change of its largest shareholder;

when there is a change of principal shareholders of a bank holding company;

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when the shareholding of the largest shareholder or a principal shareholder as prescribed under the Financial Holding Companies Act or a person who is in a special relationship with such largest or principal shareholder (as defined under the Presidential Decree of the Financial Holding Companies Act) changes by 1% or more of the total issued and outstanding voting shares of the financial holding company;

when there is a change of its name;

when there is a cause for dissolution; and

when it or its subsidiary ceases to control any of its respective direct and indirect subsidiaries by disposing of the shares of such direct and indirect subsidiaries.

***Capital Adequacy***

The Financial Holding Companies Act does not provide for a minimum paid-in capital of financial holding companies. All financial holding companies, however, are required to maintain a specified level of solvency. In addition, in its allocation of the net profit earned in a fiscal term, a financial holding company is required to set aside in its legal reserve an amount equal to at least 10% of the net income after tax each time it pays dividends on its net profits earned until its legal reserve reaches at least the aggregate amount of its paid-in capital.

A financial holding company controlling banks or other financial institutions conducting banking business as prescribed in the Financial Holding Company Act (hereinafter, the bank holding company ) is required to maintain a minimum consolidated equity capital ratio of 8.0%. Consolidated equity capital ratio is defined as the ratio of equity capital as a percentage of risk-weighted assets on a consolidated basis, determined in accordance with the Financial Services Commission requirements that have been formulated based on the Bank of International Settlements standards. Equity capital, as applicable to bank holding companies, is defined as the sum of Tier I capital, Tier II capital, and Tier III capital less any deductible items, each as defined under the Regulation on the Supervision of Financial Holding Companies. Risk-weighted assets is defined as the sum of credit risk-weighted assets and market risk-weighted assets.

For regulatory reporting purposes, we maintain allowances for credit losses on the following loan classifications that classify corporate and retail loans as required by the Financial Services Commission. In making these classifications, we take into account a number of factors, including the financial position, profitability and transaction history of the borrower, the value of any collateral or guarantee taken as security for the extension of credit, probability of default and loss amount in the event of default. This classification method, and our related provisioning policy, is intended to reflect the borrower's capacity to repay. To the extent there is any conflict between the Financial Services Commission guidelines and our internal analysis in such classifications, we adopt whichever is more conservative.

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The following table sets forth loan classifications according to the guidelines of the Financial Services Commission.

<b>Loan Classification</b>	<b>Loan Characteristics</b>
Normal	Loans made to customers whose financial position, future cash flows and nature of business are deemed financially sound. No problems in recoverability are expected.
Precautionary	Loans made to customers whose financial position, future cash flows and nature of business show potential weakness, although there is no immediate risk of nonrepayment.
Substandard	Loans made to customers whose adverse financial position, future cash flows and nature of business have a direct effect on the repayment of the loan.
Doubtful	Loans made to customers whose financial position, future cash flows and nature of business are so weak that significant risk exists in the recoverability of the loan, to the extent the outstanding amount exceeds any collateral pledged.
Estimated loss	Loans where write-off is unavoidable.

In accordance with the Regulations for the Supervision of Financial Institutions, we establish regulatory reserve for loan loss in the amount of the difference between allowance for credit losses as calculated pursuant to our provisioning policy in accordance with IFRS and allowance for credit losses based on the loan classifications set forth above as required by the Financial Services Commission. In determining consolidated equity capital ratio, we deduct regulatory reserve for loan loss from equity capital.

**Liquidity**

All financial holding companies are required to match the maturities of their assets to those of liabilities in accordance with the Financial Holding Companies Act in order to ensure liquidity. Financial holding companies are required to submit quarterly reports regarding their liquidity to the Financial Supervisory Service and must:

maintain a Won liquidity ratio (defined as Won assets due within one month, including marketable securities, divided by Won liabilities due within three months) of not less than 100%;

maintain a foreign currency liquidity ratio (defined as foreign currency liquid assets due within three months divided by foreign currency liabilities due within three months) of not less than 80% except for financial holding companies with a foreign currency liability to total assets ratio of less than 1%;

maintain a ratio of foreign currency liquid assets due within seven days less foreign currency liabilities due within seven days divided by total foreign currency assets of not less than 0%, except for financial holding companies with a foreign currency liability to total assets ratio of less than 1%; and

maintain a ratio of foreign currency liquid assets due within a month less foreign currency liabilities due within a month divided by total foreign currency assets of not less than negative 10% except for financial

holding companies with a foreign currency liability to total assets ratio of less than 1%.

***Financial Exposure to Any Single Customer and Major Shareholders***

Subject to certain exceptions, the total sum of credit (as defined in the Presidential Decree of the Financial Holding Companies Act, the Bank Act, the Presidential Decree of the Financial Investment Services and Capital Markets Act, the Insurance Act, the Mutual Savings Bank Act and the Specialized Credit Financial Business Act, respectively) of a financial holding company and its direct and indirect subsidiaries which are banks, merchant banks or securities companies ( Financial Holding Company Total Credit ) extended to a single group of companies that belong to the same conglomerate as defined in the Monopoly Regulations and Fair Trade Act will not be permitted to exceed 25% of the Net Total Equity Capital.

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*Net Total Equity Capital* for the purpose of the calculation of financial exposure to any single customer and Major Shareholder (as defined below) as applicable to us and our subsidiaries is defined under the Presidential Decree of the Financial Holding Companies Act as

- (a) the sum of:
- (i) in the case of a financial holding company, the shareholders' equity as defined under Article 24-3, Section 7(2) of the Presidential Decree of the Financial Holding Companies Act, which represents the difference between the total assets less total liabilities on the balance sheet as of the end of the most recent quarter;
  - (ii) in the case of a bank, the shareholders' equity as defined under Article 2, Section 1(5) of the Bank Act, which represents the sum of Tier I and Tier II capital amounts determined according to the standards set by the BIS;
  - (iii) in the case of a merchant bank, the capital amount as defined in Article 2, Section (1) of the Financial Investment Services and Capital Markets Act;
  - (iv) in the case of a financial investment company, the shareholders' equity as defined under Article 37, Section 3 of the Presidential Decree of the Financial Investment Services and Capital Markets Act, which represents the total shareholders' equity as adjusted as determined by the Financial Services Commission, such as the amount of increase or decrease in paid-in capital after the end of the most recent fiscal year;
  - (v) in the case of an insurance company, the shareholders' equity as defined under Article 2, Section 15 of the Insurance Act, which represents the sum of items designated by the Presidential Decree, such as paid-in-capital, capital surplus, earned surplus and any equivalent items, less the value of good will and other equivalent items;
  - (vi) in the case of a mutual savings bank, the shareholders' equity as defined under Article 2, Section 4 of the Mutual Savings Bank Act, which represents the sum of Tier I and Tier II capital amounts determined in accordance with the standards set by the Bank for International Settlements; and
  - (vii) in the case of a credit card company or a specialty credit provider, the shareholders' equity as defined under Article 2, Section 19 of the Specialized Credit Financial Business Act, which represents the sum of the items designated by the Presidential Decree, such as paid-in-capital, capital surplus, earned surplus and any equivalent items;

(b) less the sum of:

- (i) the amount of shares in direct and indirect subsidiaries held by the financial holding company;
- (ii) the amount of shares in the direct and indirect subsidiaries that are cross-held by such subsidiaries; and
- (iii) the amount of shares in the financial holding company held by its direct and indirect subsidiaries.

The Financial Holding Company Total Credit to a single individual or legal entity may not exceed 20% of the Net Total Equity Capital.

Furthermore, the total sum of credits (as defined under the Financial Holding Companies Act, the Banking Act and the Financial Investment Services and Capital Markets Act, respectively) of a bank holding company and its direct and indirect subsidiaries ( Bank Holding Company Total Credit ) extended to a Major Shareholder (together with the persons who have special relationship with such Major Shareholder) (as defined below) generally may not exceed the smaller of (x) 25% of the Net Total Equity Capital and (y) the amount of the equity capital of the financial holding company multiplied by the shareholding ratio of such Major Shareholder, subject to certain exceptions.



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*Major Shareholder* is defined under the Financial Holding Companies Act as follows:

(a) a shareholder holding (together with persons who have a special relationship with such shareholder as defined in the Presidential Decree of the Financial Holding Companies Act) in excess of 10% (or in the case of a financial holding company controlling regional banks only, 15%) in the aggregate of the financial holding company's total issued and outstanding voting shares; or

(b) a shareholder holding (together with persons who have a special relationship with such shareholder as defined in the Presidential Decree of the Financial Holding Companies Act) more than 4% in the aggregate of the total issued and outstanding voting shares of the financial holding company controlling national banks (other than a financial holding company controlling regional banks only), excluding shares related to the shareholding restrictions on non-financial business group companies as described below, where such shareholder is the largest shareholder or has actual control over the major business affairs of the financial holding company through, for example, appointment and dismissal of the officers pursuant to the Presidential Decree of the Financial Holding Companies Act.

In addition, the total sum of the Bank Holding Company Total Credit extended to all of a bank holding company's Major Shareholder may not exceed 25% of the Net Total Equity Capital. Furthermore, the bank holding company and its direct and indirect subsidiaries that intend to extend the Bank Holding Company Total Credit to the bank holding company's Major Shareholder not less than the lesser of (i) the amount equivalent to 0.1% of the Net Total Equity Capital or (ii) ₩5 billion, with respect to a single transaction, must obtain prior unanimous board resolutions and then, immediately after the completion of the transaction, must file a report with the Financial Services Commission and publicly disclose the filing of such report (for example, through a website).

***Restrictions on Transactions Among Direct and Indirect Subsidiaries and Financial Holding Company***

Generally, a direct or indirect subsidiary of a financial holding company may not extend credit to the financial holding company which directly or indirectly controls such subsidiary. In addition, a direct or indirect subsidiary of a financial holding company may not extend credit to any other single direct or indirect subsidiary of the financial holding company in excess of 10% of its stockholders' equity and to any other direct and indirect subsidiaries of the financial holding company in excess of 20% of its stockholders' equity in the aggregate. The direct or indirect subsidiaries of a financial holding company must obtain an appropriate level of collateral for the credits extended to the other direct and indirect subsidiaries unless otherwise approved by the Financial Services Commission. The appropriate level of collateral for each type of such collateral is as follows:

- (i) For deposits and installment savings, obligations of the Korean government or the Bank of Korea, obligations guaranteed by the Korean government or the Bank of Korea, obligations secured by securities issued or guaranteed by the Korean government or the Bank of Korea: 100% of the amount of the credit extended;
- (ii) (a) For obligations of local governments under the Local Autonomy Act, local public enterprises under the Local Public Enterprises Act, and investment institutions and other quasi-investment institutions under the Basic Act on the Management of Government-Invested Institution (hereinafter, the public institutions and others); (b) obligations guaranteed by the public institutions and others; and (c) obligations secured by the securities issued or guaranteed by public institutions and others: 110% of the amount of the credit extended; and

(iii) For any property other than those set forth in the above (i) and (ii): 130% of the amount of the credit extended.

Subject to certain exceptions, a direct or indirect subsidiary of a financial holding company is prohibited from owning the shares of any other direct or indirect subsidiaries (other than those directly controlled by the direct and indirect subsidiaries in question) in common control by the financial holding company. However, a direct or indirect subsidiary of a financial holding company may invest as a limited partner in a private equity

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fund that is a direct or indirect subsidiary of the same financial holding company. The transfer of certain assets subject to or below the precautionary criteria between the financial holding company and its direct or indirect subsidiary or between the direct and indirect subsidiaries of a financial holding company is prohibited except for (i) the transfer to an asset-backed securitization company, typically a special purpose entity, or the entrustment with a trust company, under the Asset-Backed Securitization Act, (ii) the transfer to a mortgage-backed securitization company under the Mortgage-Backed Securitization Company Act, (iii) the transfer or in-kind contribution to a corporate restructuring vehicle under the Corporate Restructuring Investment Company Act or (iv) the acquisition by a corporate restructuring company under the Industrial Development Act.

***Disclosure of Management Performance***

For the purpose of protecting the depositors and investors in the subsidiaries of the financial holding companies, the Financial Services Commission requires financial holding companies to disclose certain material matters including (i) financial condition and profit and loss of the financial holding company and its direct and indirect subsidiaries, (ii) how capital was raised by the financial holding company and its direct and indirect subsidiaries and how such capital was used, (iii) any sanctions levied on the financial holding company and its direct and indirect subsidiaries under the Financial Holding Companies Act or any corrective measures or sanctions under the Law on Improvement of Structure of Financial Industry or (iv) occurrence of any non-performing assets or financial incident which may have a material adverse effect.

***Restrictions on Shareholdings in Other Companies***

Subject to certain exceptions, a bank holding company may not own more than 5% of the total issued and outstanding shares of another company (other than its direct and indirect subsidiaries). If the financial holding company owns shares of another company (other than its direct and indirect subsidiaries) which is not a finance-related company, the financial holding company is required to exercise its voting rights in the same manner and same proportion as the other shareholders of the company exercise their voting rights in favor of or against any resolutions under consideration at the shareholders' meeting of the company.

***Restrictions on Shareholdings by Direct and Indirect Subsidiaries***

Generally, a direct subsidiary of a financial holding company is prohibited from controlling any other company; *provided* that a direct subsidiary of a financial holding company may control (as an indirect subsidiary of the financial holding company): (i) subsidiaries in foreign jurisdiction which are engaged in a financial business, (ii) certain financial institutions which are engaged in the business that the direct subsidiary may conduct without any licenses or permits, (iii) certain financial institutions whose business is related to the business of the direct subsidiary as prescribed under the Presidential Decree of the Financial Holding Companies Act (for example, the companies which a bank subsidiary may control are limited to credit information companies, credit card companies, trust business companies, securities investment management companies, investment advisory companies, futures business companies, and asset management companies), (iv) certain financial institutions whose business is related to financial business as prescribed by the regulations of the Ministry of Strategy and Finance, and (v) certain companies which are not financial institutions but whose business is related to the financial business of the financial holding company as prescribed by the Presidential Decree of the Financial Holding Companies Act (e.g. finance-related research company, finance-related information technology company, etc.). Acquisition by the direct subsidiaries of such indirect subsidiaries requires a prior permission from the Financial Services Commission or a report to be submitted to the Financial Services Commission, depending on the types of the indirect subsidiaries and the amount of total assets of the indirect subsidiaries.

An indirect subsidiary of a financial holding company is prohibited from controlling any other company, provided, however, that in the case where a company held control over another company at the time such company initially became an indirect subsidiary of a financial holding company, such indirect subsidiary shall be required to dispose of its interest in such other company within two years after becoming an indirect subsidiary of a financial holding company.

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A subsidiary of a financial holding company may invest in a special purpose company as its largest shareholder for purposes of making investments under the Act on Private Investment in Social Infrastructure without being deemed as controlling such special purpose company.

In addition, a private equity fund established in accordance with the Financial Investment Services and Capital Markets Act is not considered to be a subsidiary of a financial holding company even if the financial holding company is the largest investor in the private equity fund unless the financial holding company is the asset management company for the private equity fund.

***Restrictions on Transactions Between a Financial Holding Company and its Major Shareholder***

A bank holding company and its direct and indirect subsidiaries are prohibited from acquiring (including acquisition by a trust account of its subsidiary bank) shares issued by such bank holding company's Major Shareholder in excess of 1% of the Net Total Equity Capital. In addition, the financial holding company and its direct and indirect subsidiaries which intend to acquire shares issued by such Major Shareholder not less than the lesser of (i) the amount equivalent to 0.1% of the Equity Capital or (ii) ₩5 billion, with respect to a single transaction, must obtain prior unanimous board resolutions and then, immediately after the acquisition, must file a report with the Financial Services Commission and publicly disclose the filing of such report (for example, through a website).

***Restrictions on Financial Holding Company Ownership***

Under the Financial Holding Companies Act, foreign financial institutions are permitted to establish financial holding companies in Korea. Pursuant to the Presidential Decree of the Financial Holding Companies Act, a foreign financial institution can control a financial holding company if, subject to satisfying certain other conditions, it, together with its specially-related persons, holds 100% of the total shares in the financial holding company.

In addition, any single shareholder and persons who stand in a special relationship with such shareholder (as defined under the Presidential Decree to the Financial Holding Companies Act) may acquire beneficial ownership of up to 10% of the total issued and outstanding shares with voting rights of a financial holding company controlling national banks (or 15% in the case of a financial holding company controlling regional banks only). The Government and the Korea Deposit Insurance Corporation are not subject to such a ceiling.

However, non-financial business group companies (as defined below) may not acquire beneficial ownership of shares of a bank holding company in excess of 4% of such financial holding company's outstanding voting shares, provided that such non-financial business group companies may acquire beneficial ownership of up to 10% of such financial holding company's outstanding voting shares with the approval of the Financial Services Commission under the condition that such non-financial business group companies will not exercise voting rights in respect of such shares in excess of the 4% limit. In addition, any person (whether a Korean national or a foreigner), with the exception of non-financial business group companies described above, may also acquire in excess of 10% of total voting shares issued and outstanding of a financial holding company which controls national bank, provided that an approval from the Financial Services Commission is obtained in instances where the total holding exceeds 10% (or 15% in the case of a financial holding company controlling regional banks only), 25% or 33% of the total voting shares issued and outstanding of such bank holding company.

*Non-financial business group companies* are defined under the Financial Holding Companies Act as companies, which include:

- (i) any same shareholder group with aggregate net assets of all non-financial business companies belonging to such group of not less than 25% of the aggregate net assets of all members of such group;
  
- (ii) any same shareholder group with aggregate assets of all non-financial business companies belonging to such group of not less than ₩2 trillion;

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- (iii) any mutual fund in which a same shareholder group identified in item (i) or (ii) above holds more than 4% of the total shares issued and outstanding of such mutual fund;
- (iv) any private equity fund (x) which has a partner with limited liability that falls under item (i), (ii) or (iii) above and holds equity equivalent to 10% or greater of the total amount invested by the private equity fund, (y) which has a partner with unlimited liability that falls under item (i), (ii) or (iii) above or (z) whose affiliates belonging to an enterprise group subject to limitation on mutual investment hold in aggregate equity equivalent to 30% or greater of the total amount invested by such private equity fund; or
- (v) any investment purpose company in which a private equity fund that falls under item (iv) above acquires and holds no less than 4% of such company's shares or equity or exercises de-facto influence on such company's significant managerial matters.

## **Financial Investment Services and Capital Markets Act**

### ***General***

The Financial Investment Services and Capital Markets Act categorizes capital markets-related business into six different functions, as follows:

dealing (trading and underwriting of financial investment products (as defined below));

brokerage (brokerage of financial investment products);

collective investment (establishment of collective investment schemes and the management thereof);

investment advice;

discretionary investment management; and

trusts (together with the five business set forth above, the Financial Investment Businesses ).

Accordingly, all financial business relating to financial investment products are reclassified as one or more of the Financial Investment Businesses described above, and financial institutions are subject to the regulations applicable to their relevant Financial Investment Businesses, irrespective of the type of the financial institution it is. For example, under the Financial Investment Services and Capital Markets Act, derivative businesses conducted by securities companies and future companies will be subject to the same regulations under the Financial Investment Services and Capital Markets Act, at least in principle.

The banking business and insurance business are not subject to the Financial Investment Services and Capital Markets Act and will continue to be regulated under separate laws; provided, however, that they may become subject to the

Financial Investment Services and Capital Markets Act if their activities involve any financial investment businesses requiring a license based on the Financial Investment Services and Capital Markets Act.

***Comprehensive Definition of Financial Investment Products***

In an effort to encompass the various types of securities and derivative products available in the capital markets, the Financial Investment Services and Capital Markets Act sets forth a comprehensive term financial investment products, defined to mean all financial products with a risk of loss in the invested amount (in contrast to deposits, which are not financial investment products for which the invested amount is protected or preserved). Financial investment products are classified into two major categories: (i) securities (relating to financial investment products where the risk of loss is limited to the invested amount) and (ii) derivatives (relating to financial investment products where the risk of loss may exceed the invested amount). As a result of the general and open-ended manner in which financial investment products are defined, any future financial product could potentially fall under the definition of financial investment products, which would enable Financial



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Investment Companies (as defined below) to handle a broader range of financial products. Under the Financial Investment Services and Capital Markets Act, securities companies, asset management companies, futures companies and other entities engaging in any Financial Investment Business are classified as Financial Investment Companies.

***License System***

Financial Investment Companies are able to choose what Financial Investment Business to engage in (through the check the box method set forth in the relevant license application), by specifying the desired (i) Financial Investment Business, (ii) financial investment product and (iii) target customers to which financial investment products may be sold (namely, general investors or professional investors). Licenses will be issued under the specific business sub-categories described above. For example, it would be possible for a Financial Investment Company to obtain a license to engage in the Financial Investment Business of (i) dealing (ii) over the counter derivatives products (iii) only with professional investors.

***Expanded Business Scope of Financial Investment Companies***

Under the previous regulatory regime in Korea, it was difficult for a financial institution to explore a new line of business or expand upon its existing line of business. For example, a financial institution licensed as a securities company generally could not engage in the asset management business. In contrast, under the Financial Investment Services and Capital Markets Act, pursuant to the integration of its current business involving financial investment products into a single Financial Investment Business, a licensed Financial Investment Company is permitted to engage in all types of Financial Investment Businesses, subject to compliance with the relevant regulations, for example, maintaining an adequate Chinese Wall, to the extent required. As to incidental businesses (i.e., a financial related business which is not a Financial Investment Business), the Financial Investment Services and Capital Markets Act generally allows a Financial Investment Company to freely engage in such incidental businesses by shifting away from the previous system of permitting only the listed activities towards a more comprehensive system. In addition, a Financial Investment Company is permitted (i) to outsource marketing activities by contracting with introducing brokers that are individuals but not employees of the Financial Investment Company, (ii) to engage in foreign exchange business related to their Financial Investment Business and (iii) to participate in the settlement network, pursuant to an agreement among the settlement network participants.

***Improvement in Investor Protection Mechanism***

While the Financial Investment Services and Capital Markets Act broadens the scope of financial businesses in which financial institutions are permitted to engage, a more rigorous investor-protection mechanism is imposed upon Financial Investment Companies dealing in financial investment products. The Financial Investment Services and Capital Markets Act makes a distinction between general investors and sophisticated investors and provides new or enhanced protections to general investors. For instance, the Financial Investment Services and Capital Markets Act expressly provides for strict know-your-customer rules for general investors and imposes an obligation on Financial Investment Companies that they should market financial investment products suitable to each general investor considering his or her personal attributes, including investment objective, net worth, and investment experience. Under the Financial Investment Services and Capital Markets Act, a Financial Investment Company can be held liable if a general investor proves (i) damages or losses relating to such general investor's investment in financial investment products solicited by such Financial Investment Company and (ii) absence of explanation, false explanation, or omission of material fact (without having to prove fault or causation). In case there are any conflicts of interest between the Financial Investment Companies and investors, the Financial Investment Services and Capital Markets Act expressly requires (i) disclosure of any conflict of interest to investors and (ii) mitigation of conflicts of interest to a comfortable level or abstention from the relevant transaction.



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**Table of Contents*****Other Regulatory Changes Related to Securities and Investments***

The Financial Investment Services and Capital Markets Act brought changes to various rules in securities regulations including those relating to public disclosure, insider trading and proxy contests, which had previously been governed by the Securities and Exchange Act. For example, the 5% and 10% reporting obligations under the Securities and Exchange Act have become more stringent under the Financial Investment Services and Capital Markets Act. For instance, the numbers of events requiring an investor to update its 5% report have increased under the Financial Investment Services and Capital Markets Act. Previously, only a change in the shareholding of 1% or more or in the purpose of shareholding (such as an intention to influence management) could trigger the obligation to update the 5% report. The Government has issued detailed regulations stipulating additional events requiring updates to 5% reports, such as the change in the type of holding and change in any major aspect of the relevant contract. As for the 10% report filing obligation, the initial filing is expected to be required to be made within five business days of the date of the event triggering the 10% reporting obligation, compared to 10 calendar days under the previous law. The due date for reporting a subsequent change after the initial 10% report filing has been reduced from the 10th day of the first month immediately following the month in which such change took place to five business days of the date of such change. Under the previous law, there had been a limitation on the type of investment vehicles that could be used in a collective investment scheme (namely, to trusts and corporations), the type of funds that could be used for collective investments, and the types of assets and investment securities a fund could invest in. However, the Financial Investment Services and Capital Markets Act significantly liberalizes these restrictions, permitting all legal entities, including limited liability companies or partnerships, to be used for the purpose of collective investments, allowing the formation of fund complexes and permitting investment funds to invest in a wide variety of different assets and investment instruments.

**Principal Regulations Applicable to Banks*****General***

The banking system in Korea is governed by the Banking Act of 1950, as amended (the Banking Act) and the Bank of Korea Act of 1950, as amended (the Bank of Korea Act). In addition, Korean banks are subject to the regulations and supervision of the Bank of Korea, the Bank of Korea's Monetary Policy Committee, the Financial Services Commission and its executive body, the Financial Supervisory Service.

The Bank of Korea, established in 1950 under the Bank of Korea Act, performs the customary functions of a central bank. It seeks to contribute to the sound development of the national economy by price stabilization through establishing and implementing efficient monetary and credit policies. The Bank of Korea acts under instructions of the Monetary Policy Committee, the supreme policy-making body of the Bank of Korea.

Under the Bank of Korea Act, the Monetary Policy Committee's primary responsibilities are to formulate monetary and credit policies and to determine the operations, management and administration of the Bank of Korea. The Financial Services Commission, established in 1998, regulates commercial banks pursuant to the Banking Act, including establishing guidelines on capital adequacy of commercial banks, and promulgates regulations relating to supervision of banks. Furthermore, pursuant to the Amendment to the Government Organization Act and the Banking Act in 1999, the Financial Services Commission, instead of the Ministry of Strategy and Finance, now regulates market entry into the banking business.

The Financial Supervisory Service is subject to the instructions and directives of the Financial Services Commission and carries out supervision and examination of commercial banks. In particular, the Financial Supervisory Service sets requirements both for the prudent control of liquidity and for capital adequacy and establishes reporting requirements

pursuant to the authority delegated to it under the Financial Services Commission regulations, pursuant to which banks are required to submit annual reports on financial performance and shareholdings, regular reports on management strategy and non-performing loans, including write-offs, and management of problem companies and plans for the settlement of bad loans.

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Under the Banking Act, approval to commence a commercial banking business or a long-term financing business must be obtained from the Financial Services Commission. Commercial banking business is defined as the lending of funds acquired predominantly from the acceptance of deposits for a period not exceeding one year or, subject to the limitation established by the Financial Services Commission, for a period between one year and three years. Long-term financing business is defined as the lending, for periods in excess of one year, of funds acquired predominantly from paid-in capital, reserves or other retained earnings, the acceptance of deposits with maturities of at least one year, or the issuance of bonds or other securities. A bank wishing to enter any business other than commercial banking and long-term financing businesses, such as the trust business, must obtain approval from the Financial Services Commission. Approval to merge with any other banking institution, to liquidate, to close a banking business or to transfer all or a part of a business must also be obtained from the Financial Services Commission.

If the Korean government deems a bank's financial condition to be unsound or if a bank fails to meet the applicable capital adequacy ratio set forth under Korean law, the government may order:

admonition, warnings or reprimands with respect to our officers and employees;

capital increases or reductions;

suspension of officers from performing their duties and appointment of custodians;

stock cancellations or consolidations;

transfers of a part or all of business;

sale of assets;

closures of subsidiaries or branch offices or downsizing of offices / workforce.

mergers or becoming a subsidiary under the Financial Holding Companies Act of a financial holding company;

acquisition of a bank by a third party;

suspensions of a part or all of business operation; and

assignments of contractual rights and obligations relating to financial transactions.

### *Capital Adequacy*

The Banking Act requires nationwide banks to maintain a minimum paid-in capital of ₩100 billion and regional banks to maintain a minimum paid-in capital of ₩25 billion.

In addition to minimum capital requirements, all banks including foreign bank branches in Korea are required to maintain a prescribed solvency position. A bank must also set aside as its legal reserve an amount equal to at least 10% of its net profits after tax each time it pays dividends on net profits earned until such time when the reserve equals the amount of its total paid-in capital.

Under the Banking Act, the capital of a bank is divided into two categories: Tier I and Tier II capital. Tier I capital (core capital) consists of (i) Tier I common equity capital including paid-in capital, capital surplus and retained earnings related to common equity and accumulated other comprehensive gains and losses, and (ii) other Tier I capital, including paid-in capital and capital surplus related to hybrid Tier I capital instruments that, among other things, qualify as contingent capital and are subordinated to subordinated debt. Tier II capital (supplementary capital) consists of revaluation reserves, gain on valuation of investment in securities, allowance for bad debts set aside for loans classified as normal or precautionary, perpetual subordinated debt, cumulative preferred shares, redeemable preferred shares (with a right to redeem after the fifth anniversary of the date of issuance) and certain other subordinated debt.

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All banks must meet standards regarding minimum ratios of Tier I and Tier II capital (less any capital deductions) to risk-weighted assets, determined in accordance with the Financial Services Commission requirements that have been formulated based on the BIS Standards. These standards were adopted and became effective in 1996. Under these regulations, all domestic banks and foreign bank branches were required to meet the minimum ratio of Tier I and Tier II capital (less any capital deductions) to risk-weighted assets of 8%. In July and September 2013, the Financial Services Commission promulgated amended regulations implementing Basel III in Korea, pursuant to which Korean banks and bank holding companies are required to maintain a minimum ratio of Tier I common equity capital to risk-weighted assets of 3.5% and Tier I capital to risk-weighted assets of 4.5% from December 1, 2013, which minimum ratios were increased to 4.0% and 5.5%, respectively, from January 1, 2014 and increased further to 4.5% and 6.0%, respectively, from January 1, 2015. Such requirements are in addition to the pre-existing requirement of a minimum ratio of Tier I and Tier II capital (less any capital deductions) to risk-weighted assets of 8.0%, which remains unchanged. The amended regulations also contemplate an additional capital conservation buffer of 0.625% starting in 2016, with such buffer to increase in stages to 2.5% by 2019.

Under the Regulation on the Supervision of the Banking Business and the Detailed Regulations promulgated thereunder, Korean banks apply the following risk-weight ratios in respect of their home mortgage loans:

(1) for those banks adopting a standardized approach for calculating credit risk capital requirements, the risk-weight ratio of 35% (if the loan is fully secured by a first ranking mortgage) and 50% (in the case of high-risk home mortgage loans); and

(2) for those banks adopting an internal ratings-based approach for calculating credit risk capital requirements, a risk-weight ratio calculated with reference to the probability of default, loss given default and exposure at default, each as defined in the Detailed Regulations on the Supervision of the Banking Business.

In Korea, Basel II, a convention entered into by the Basel committee in 2004 for the purpose of improving risk management and increasing capital adequacy of banks, was implemented beginning in 2008. Pursuant to Basel II, operational risk, such as inadequate procedure, loss risk by employees, internal system, occurrence of unexpected event, as well as credit risk and market risk, is taken into account in calculating the risk-weighted assets, in addition to maintaining the capital adequacy ratio of 8% for banks. Under Basel II, the capital requirements for credit risk can be calculated by the internal rating based (IRB) approach or the standardized approach.

Under the standardized approach, a home mortgage loan fully secured by a residential property, which is or will be occupied by a borrower, is risk-weighted at 35%.

Under the Regulation on the Supervision of the Banking Business, banks generally must maintain allowances for credit losses in respect of their outstanding loans and other credits (including confirmed guarantees and acceptances and trust account loans) in an aggregate amount covering not less than:

0.85% of normal credits (or 0.9% in the case of normal credits comprising loans to certain industries including construction, retail and wholesale sales, accommodations, restaurant, real estate and lease, 1.0% in the case of normal credits comprising loans to individuals and households, 2.5% in the case of normal credits comprising card loan assets and revolving assets and 1.1% in the case of normal credits comprising other card assets such as claims arising from the use of a credit card, a debit card or a prepaid card ( other card assets ));

7% of precautionary credits (or 10% in the case of precautionary credits comprising loans to individuals and households, 50% in the case of precautionary credits comprising card loan assets and revolving assets and 40% in the case of other card assets);

20% of substandard credits (or 10% in the case of substandard credits comprising assets for which a bank has the right to receive repayment in preference ( assets subject to preferential repayment ) under



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the Corporate Restructuring Promotion Act or the Debtor Rehabilitation and Bankruptcy Act, 65% in the case of substandard credits comprising card loan assets and revolving assets and 60% in the case of substandard credits comprising other card assets);

50% of doubtful credits (or 25% in the case of doubtful credits comprising assets subject to preferential repayment, 55% in the case of doubtful credits comprising loans to individuals and households and 75% in the case of doubtful credits comprising other card assets); and

100% of estimated loss credits (or 50% in the case of estimated loss credits comprising assets subject to preferential repayment).

Furthermore, under the Regulation on the Supervision of the Banking Business, banks must maintain allowances for credit losses in respect of their confirmed guarantees (including confirmed acceptances) and outstanding non-used credit lines as of the settlement date in an aggregate amount calculated at the same rates applicable to normal, precautionary, substandard and doubtful credits comprising their outstanding loans and other credits as set forth above.

***Liquidity***

All banks are required to match the maturities of their assets and liabilities in accordance with the Banking Act in order to ensure adequate liquidity. Banks may not invest in excess of an amount exceeding 100% of their Tier I and Tier II capital (less any capital deductions) in stocks and other securities with a period remaining to maturity of over three years. However, this restriction does not apply to government bonds or to Monetary Stabilization Bonds issued by the Bank of Korea.

The Financial Services Commission requires each Korean bank to maintain a Won liquidity ratio (defined as Won assets due within one month, including marketable securities, divided by Won liabilities due within one month) of not less than 100% and to make monthly reports to the Financial Supervisory Service. The Financial Services Commission also requires each Korean bank to (1) maintain a liquidity coverage ratio of 80% or higher from January 1, 2015 until December 31, 2015 with such minimum liquidity coverage ratio to increase in increments of 5% per year to 100% by 2019, by holding a stock of highly-liquid assets with a value equal to or greater than such bank's total net cash outflows over a month period, subject to certain exceptions, (2) maintain a foreign-currency liquidity ratio due within three months (defined as foreign-currency liquid assets due within three months divided by foreign-currency liabilities due within three months) of not less than 85%, (3) maintain a ratio of foreign-currency liquid assets due within seven days (defined as foreign-currency liquid assets due within seven days less foreign-currency liabilities due within seven days, divided by total foreign-currency assets) of not less than negative 3%, (4) maintain a ratio of foreign-currency liquid assets due within a month (defined as foreign-currency liquid assets due within a month less foreign currency liabilities due within a month, divided by total foreign-currency assets) of not less than negative 10%, and (5) submit monthly reports with respect to the maintenance of these ratios. The Financial Services Commission also requires each Korean bank to submit monthly reports with respect to its compliance with these ratios.

The Monetary Policy Committee is authorized to fix and alter minimum reserve requirements that banks must maintain against their deposit liabilities. The current minimum reserve ratio is 7.0% of average balances for Won-denominated demand deposits outstanding, 0.0% of average balances for Won-denominated employee asset establishment savings deposits, employee long-term savings deposits, employee house purchase savings deposits, long-term house purchase savings deposits, household long-term savings deposits and employee preferential savings

deposits outstanding and 2.0% of average balances for Won-denominated time and savings deposits, mutual installments, housing installments and certificates of deposit outstanding. For foreign currency deposit liabilities, a 2.0% minimum reserve ratio is applied to savings deposits outstanding and a 7.0% minimum reserve ratio is applied to demand deposits, while a 1.0% minimum reserve ratio is applied for offshore accounts, immigrant accounts and resident accounts opened by foreign exchange banks.

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**Table of Contents*****Loan-to-Deposit Ratio***

In 2009, the Financial Supervisory Service announced that it would introduce a new set of regulations on the loan-to-deposit ratio by amending the Regulation on the Supervision of the Banking Business upon its determination that the overall liquidity of banks in Korea had become unstable due to the ongoing increase in the loan-to-deposit ratio resulting from banks expanding their asset size too competitively by granting mortgages on houses and loans to small- and medium-sized enterprises over the last couple of years. The Regulation on the Supervision of the Banking Business, which was amended as of August 18, 2010 and became effective on January 1, 2014, requires banks with Won-denominated loans of more than ₩2 trillion in value to maintain a ratio of Won-denominated loans to Won-denominated deposits lower than 1:1. In practice, however, the Financial Supervisory Service instructed relevant banks to comply with this newly enacted loan-to-deposit ratio by the end of June 2012. Shinhan Bank's loan-to-deposit ratio as of December 31, 2014 was 98.0%.

***Financial Exposure to Any Single Customer and Major Shareholders***

Under the Banking Act, the sum of material credit exposures by a bank, namely, the total sum of its credits to single individuals, legal entities or groups of companies belonging to the same enterprise groups as defined in the Monopoly Regulation and Fair Trade Act that exceed 10% of the sum of Tier I and Tier II capital (less any capital deductions), must not exceed five times the sum of Tier I and Tier II capital (less any capital deductions), subject to certain exceptions. Subject to certain exceptions, no bank is permitted to extend credit (including loans, guarantees, purchases of securities (only in the nature of a credit) and such other transactions which directly or indirectly create credit risk) in excess of 20% of the sum of Tier I and Tier II capital (less any capital deductions) to a single individual or a legal entity, and no bank may grant credit in excess of 25% of the sum of Tier I and Tier II capital (less any capital deductions) to a single group of companies that belong to the same enterprise group as defined in the Monopoly Regulations and Fair Trade Act.

Under the Banking Act, certain restrictions apply to extending credits to a major shareholder. The definition of a major shareholder is as follows:

a shareholder holding (together with persons who have a special relationship with such shareholder as defined in the Presidential Decree of the Banking Act) in excess of 10% (or in the case of regional banks, 15%) in the aggregate of the bank's total issued and outstanding voting shares; or

a shareholder holding (together with persons who have a special relationship with such shareholder as defined in the Presidential Decree of the Banking Act) more than 4% in the aggregate of the total issued and outstanding voting shares of a bank (other than a regional bank), where such shareholder is the largest shareholder or is able to actually control the major business affairs of the bank, for example, through appointment and dismissal of the chief executive officer or of the majority of the executives.

Under the Banking Act, banks are prohibited from extending credits in the amount greater than the lesser of (1) 25% of the sum of such bank's Tier I and Tier II capital (less any capital deductions) and (2) the relevant major shareholder's shareholding ratio multiplied by the sum of the bank's Tier I and Tier II capital (less any capital deductions) to a major shareholder (together with persons who have special relationship with such major shareholder as defined in the Presidential Decree of the Banking Act). Also, no bank is allowed to grant credit to its major shareholders in the aggregate in excess of 25% of its Tier I and Tier II capital (less any capital deductions).

When managing the credit risk of banks, among the methods for providing credit support by banks, a loan agreement, a purchase agreement for asset-backed commercial papers, purchase of subordinate beneficiary certificates, and assumption of liability by providing warranty against default under asset-backed securitization are examples of creating financial exposure to banks.

***Interest Rates***

Korean banks remain dependent on the acceptance of deposits as their primary source of funds. Currently, there are no legal controls on interest rates on bank loans in Korea except for a cap of 34.9% on the default interest rate under the Act on Lending Business, which cap will remain effective until December 31, 2015.

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### ***Lending to Small- and Medium-sized Enterprises***

When commercial banks (including Shinhan Bank) make Won-denominated loans to certain start-up, venture, innovative and other strategic small- and medium-sized enterprises specially designated by the Bank of Korea as priority borrowers, the Bank of Korea generally provides the underlying funding to these banks at concessionary rates for up to 50% of all such loans made to the priority borrowers subject to a monthly-adjusted limit prescribed by the Bank of Korea (currently ₩5 trillion) *provided that* if such loans to priority borrowers made by all commercial banks exceed the prescribed limit for a given month, the concessionary funding for the following month will be allocated to each commercial bank in proportion to such bank's lending to priority borrowers two months prior to the time of such allocation, which has the effect that, if a particular bank lags other banks in making loans to priority borrowers, the amount of funding such bank can receive from the Bank of Korea at concessionary rates will be proportionately reduced.

### ***Disclosure of Management Performance***

For the purpose of enforcing mandatory disclosure of management performance so that the general public, especially depositors and stockholders, will be in a better position to monitor banks, the Financial Services Commission requires commercial banks to disclose certain matters as follows:

loans bearing no profit made to a single business group in an amount exceeding 10% of the sum of the bank's Tier I and Tier II capital (less any capital deductions) as of the end of the previous month (where the loan exposure to such borrower is calculated as the sum of substandard credits, doubtful credits and estimated loss credits) except where the loan exposure to a single business group is not more than ₩4 billion;

occurrence of any financial event involving embezzlement, malfeasance or misappropriation of funds, for which the damage amount is expected to exceed ₩1 billion, or the Governor of the Financial Supervisory Service has made a public announcement regarding such an occurrence; and

any loss due to court judgments or similar decisions in civil proceedings in an amount exceeding 1% of the sum of the bank's Tier I and Tier II capital (less any capital deductions) as of the end of the previous month except where the loss is not more than ₩1 billion.

### ***Restrictions on Lending***

According to the Banking Act, commercial banks are prohibited from making any of the following categories of loans:

loans made directly or indirectly on the pledge of a bank's own shares (subject to certain exceptions with respect to financing for infrastructure projects);

loans made directly or indirectly to enable a natural or a legal person to buy the bank's own shares; and

loans made to any of the bank's officers or employees other than de minimis loans of up to (1) ~~₩~~20 million in the case of a general loan, (2) ~~₩~~50 million in the case of a general loan plus a housing loan, or (3) ~~₩~~60 million in the aggregate for general loans, housing loans and loans to pay damages arising from wrongful acts of employees in financial transactions.

***Recent Regulations Relating to Retail Household Loans***

The Financial Services Commission implemented a number of changes in recent years to the mechanisms by which a bank evaluates and reports its retail household loan balances and has proposed implementing further changes. Due to a rapid increase in the number of loans secured by homes and other forms of housing, the Financial Services Commission and the Financial Supervisory Service implemented regulations designed to curtail extension of new or refinanced loans secured by housing, including the following:

as to loans secured by collateral of housing (including apartments) located nationwide, the loan-to-value ratio (the aggregate principal amount of loans secured by such collateral over the appraised value of the collateral) should not exceed 60%;

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as to loans secured by collateral of housing (including apartments) located in areas of excessive investment or housing (excluding apartments) located in areas of high speculation, in each case, as designated by the government, (i) the loan-to-value ratio for loans with a maturity of not more than three years should not exceed 50% and (ii) the loan-to-value ratio for loans with a maturity of more than three years should not exceed 60%;

as to loans secured by collateral of housing (regardless of housing type or location) to be amortized over the period of ten years, the loan-to-value ratio should not exceed 70%; provided, that the loans (i) have a fixed rate of interest with (a) redemption period/term of not more than one year and (b) debt-to-income ratio of not more than 40%, and (ii) within one year, have either (x) plans for sale to Korea Housing Finance Corporation, or (y) separate securitization plans;

as to loans secured by apartments located in areas of high speculation as designated by the government, (i) the loan-to-value ratio for loans with a maturity of not more than ten years should not exceed 40%; and (ii) the loan-to-value ratio for loans with a maturity of more than ten years should not exceed (a) 40%, if the price of such apartment is over ₩600 million, and (b) 60%, if the price of such apartment is ₩600 million or lower;

as to loans secured by apartments with appraisal value of more than ₩600 million in areas of high speculation as designated by the government or certain metropolitan areas designated as areas of excessive investment by the government, the borrower's debt-to-income ratio (calculated as (i) the aggregate annual total payment amount of (x) the principal of and interest on loans secured by such apartment(s) and (y) the interest on other debts of the borrower over (ii) the borrower's annual income) should not exceed 40%;

as to apartments located in areas of high speculation as designated by the government, a borrower is permitted to have only one new loan secured by such apartment;

where a borrower has two or more loans secured by apartments located in areas of high speculation as designated by the government, the loan with the earliest maturity date must be repaid first and the number of loans must be eventually reduced to one; and

in the case of a borrower (i) whose spouse already has a loan secured by housing or (ii) who is single and under 30 years old, the debt-to-income ratio of the borrower in respect of loans secured by apartment(s) located in areas of high speculation as designated by the government should not exceed 40%.

***Restrictions on Investments in Property***

A bank may possess real estate property if and only to the extent necessary for conducting its business; provided that the aggregate value of such real estate property must not exceed 60% of the sum of its Tier I and Tier II capital (less any capital deductions). Any property acquired by a bank (1) through the exercise of its rights as a secured party or (2) the acquisition of which is prohibited by the Banking Act must be disposed of within one year, subject to certain exceptions.

***Restrictions on Shareholdings in Other Companies***

Under the Banking Act, a bank may not own more than 15% of shares outstanding with voting rights of another company, except where, among other reasons:

the company issuing such shares is engaged in a business that falls under the category of financial businesses set forth by the Financial Services Commission (including companies which business purpose is to own equity interests in private equity funds); or

the acquisition of shares by the bank is necessary for corporate restructuring of such company and is approved by the Financial Services Commission.



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In the above cases, a bank's total investment in a company in which the bank owns more than 15% of shares outstanding with voting rights ( subsidiary ) shall not exceed:

an amount equivalent to 15% of the sum of such bank's Tier I and Tier II capital; or

an amount equivalent to 30% of the sum of such bank's Tier I and Tier II capital if the bank and its subsidiary, after consideration of their managerial condition, satisfy the requirements prescribed and published by the Financial Services Commission.

The Banking Act provides that a bank using its bank accounts and its trust accounts is not permitted to acquire the shares issued by the Major Shareholder of such bank in excess of an amount equal to 1% of the sum of Tier I and Tier II capital (less any capital deductions).

***Restrictions on Bank Ownership***

Under the Banking Act, subject to certain exceptions, a single shareholder and persons who stand in a special relationship with such shareholder (as described in the Presidential Decree to the Banking Act) may acquire beneficial ownership of up to 10% of a national bank's total issued and outstanding shares with voting rights and up to 15% of a regional bank's total issued and outstanding shares with voting rights. The government, the Korea Deposit Insurance Corporation and financial holding companies qualifying under the Financial Holding Companies Act are not subject to such ceilings. However, non-financial business group companies—namely, (1) any same shareholder group with an aggregate net assets of all non-financial companies belonging to such group of not less than 25% of the aggregate net assets of all corporations that are members of such group; (2) any group with aggregate assets of all non-financial companies belonging to such group of not less than ₩2 trillion; (3) any mutual fund in which a same shareholder group, as described in items (1) and (2) above, owns more than 4% of the total shares issued and outstanding; (4) a private equity fund (under the Financial Investment Services and Capital Markets Act) where (i) the general partner of such private equity fund, (ii) the limited partner whose equity holding ratio in such private equity fund is 18% or more, or (iii) the limited partners, being member companies of a single group of companies that belong to the same conglomerate as defined in the Monopoly Regulations and Fair Trade Act, whose aggregate equity holding ratio in such private equity fund is 36% or more falls under either of item (1) to (3) above; or (5) a special purpose company of a private equity fund where a private equity fund, as described in item (4) above, owns 4% or more of the special purpose company's issued and outstanding shares or has actual control over the major business affairs of the special purpose company through, for example, appointment and dismissal of the officers—may not acquire beneficial ownership of shares of a national bank in excess of 4% of such bank's outstanding voting shares, and must obtain the approval of the Financial Services Commission in order to acquire beneficial ownership of shares of a national bank in excess of 4% of such bank's outstanding voting shares if, through such acquisition, the non-financial business group companies become the largest shareholder of such bank or have actual control over the major business affairs of such bank through the methods set out in the Enforcement Decree of the Banking Act such as appointment and dismissal of the officers; provided that such non-financial business group companies may acquire beneficial ownership of:

up to 10% of a national bank's outstanding voting shares with the approval of the Financial Services Commission under the condition that such non-financial group companies will not exercise voting rights in respect of such shares in excess of the 4% limit; and

in the event that a foreigner, as defined in the Foreign Investment Promotion Act, owns in excess of 4% of a national bank's outstanding voting shares, up to 10% of such bank's outstanding voting shares without the approval of the Financial Services Commission, and in excess of 10%, 25% or 33% of such bank's outstanding voting shares, with the approval of the Financial Services Commission, up to the number of shares owned by such foreigner.

In addition, any person (whether a Korean national or a foreigner), with the exception of non-financial business group companies described above, may also acquire in excess of 10% of a national bank's total voting

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shares issued and outstanding, provided that an approval from the Financial Services Commission is obtained in instances where the total holding exceeds 10% (or 15% in the case of regional banks), 25% or 33% of the bank's total voting shares issued and outstanding.

### ***Deposit Insurance System***

The Depositor Protection Act provides, through a deposit insurance system, insurance for certain deposits of banks in Korea. Under the Depositor Protection Act, all banks governed by the Banking Act, including Shinhan Bank and Jeju Bank, are required to pay to the Korea Deposit Insurance Corporation an insurance premium on a quarterly basis at such rate as determined by the Presidential Decree to the Depositor Protection Act, which shall not exceed 0.5% of the bank's insurable deposits in any given year. The current insurance premium is 0.02% of insurable deposits for each quarter. If the Korea Deposit Insurance Corporation pays the insured amount, it will acquire the claims of the depositors within the payment amount. Under current rules, the Korea Deposit Insurance Corporation insures only up to a total of ₩50 million per an individual for deposits and interest in a single financial institution, regardless of when the deposits were made and the size of the deposits.

### ***Trust Business***

A bank that intends to enter into the trust business must obtain the approval of the Financial Services Commission. Trust activities of banks are governed by the Financial Investment Services and Capital Markets Act. Banks engaged in the banking business and trust business are subject to certain legal and accounting procedures requirements, including the following:

under the Banking Act, the Financial Investment Services and Capital Markets Act and the Trust Act, assets accepted in trust by a bank in Korea must be segregated from its other assets in the accounts of such bank; accordingly, banks engaged in the banking and trust businesses must maintain two separate accounts, the banking accounts and the trust accounts, and two separate sets of records which provide details of their banking and trust businesses, respectively; and

assets comprising the trust accounts are not available to depositors or other general creditors of such bank in the event the trustee is liquidated or is wound up.

In the event that a bank qualifies and operates as an asset management company, a trustee, a custodian or a general office administrator under the Financial Investment Services and Capital Markets Act, it is required to establish relevant operation and management systems to prevent potential conflicts of interest among the banking business, the asset management business, the trustee or custodian business and general office administration. These measures include:

prohibitions against officers, directors and employees of one particular business operation from serving as an officer, director and employee in another business operation, except where an officer or a director (1) serving in two or more business operations with no significant conflict of interest in accordance with the Presidential Decree on the Financial Investment Services and Capital Markets Act or (2) serving in a trustee business or a custodian business and simultaneously serving in a general office administrator business in accordance with the Financial Investment Services and Capital Markets Act;

prohibitions against the joint use or sharing of computer equipment or office equipment; and

prohibitions against the sharing of information by and among officers, directors and employees engaged in the different business operations.

A bank which qualifies and operates as an asset management company may engage in the sale of beneficiary certificates of investment trusts which are managed by such bank. However, such bank is prohibited from engaging in the following activities:

acting as trustee of an investment trust managed by such bank;

purchasing with such bank's own funds beneficiary certificates of an investment trust managed by such bank;

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using in its sales activities of other collective investment securities information relating to the trust property of an investment trust managed by such bank;

selling through a financial institution established under the Banking Act beneficiary certificates of an investment trust managed by such bank;

establishing a short-term financial indirect investment vehicle; and

establishing a mutual fund.

### ***Laws and Regulations Governing Other Business Activities***

To enter the foreign exchange business, a bank must register with the Minister of the Ministry of Strategy and Finance. The foreign exchange business is governed by the Foreign Exchange Transaction Law. To enter the securities business, a bank must obtain the approval of the Financial Services Commission. The securities business is governed by regulations under the Financial Investment Services and Capital Markets Act. Pursuant to the above-mentioned laws, banks are permitted to engage in the foreign exchange business and the underwriting business for government and other public bonds.

Recently, regulatory authorities are encouraging financial institutions to lower the automatic teller machines ( ATM ) usage fees in order to decrease the financial expense burden on consumers. Further, in light of the increasing household debt, regulatory authorities are encouraging financial institutions to gradually increase the proportion of the principal of retail loans that are subject to the fixed interest rates from the currently effective proportion of 10% of the principal amount to 15% and 30% by 2012 and 2016, respectively.

### **Principal Regulations Applicable to Credit Card Companies**

#### ***General***

Any person, including a bank, wishing to engage in the credit card business must obtain a license from the Financial Services Commission. In addition, in order to enter the credit card business, a bank must obtain a license from the Financial Services Commission (hereinafter, a bank which obtains such license is defined as licensed bank engaged in the credit card business ). The credit card business is regulated and governed by the Specialized Credit Financial Business Act. Under the Specialized Credit Financial Business Act and regulations thereunder, a company in the same conglomerate group (as defined in the Monopoly Regulation and Fair Trade Act) may engage in the credit card business even though another company in the same conglomerate group is already engaged in such business, which was previously not permitted.

The Specialized Credit Financial Business Act establishes guidelines on capital adequacy and provides for other regulations relating to the supervision of credit card companies. The Specialized Credit Financial Business Act delegates regulatory authority over credit card companies to the Financial Services Commission and its executive body, the Financial Supervisory Service.

A licensed bank engaging in the credit card business is regulated by the Financial Services Commission and the Financial Supervisory Service.

The Financial Services Commission regulates credit card companies and licensed banks engaged in the credit card business by establishing guidelines or regulations on management of such companies. Moreover if the Financial Services Commission deems the financial condition of a credit card company or a licensed bank engaged in the credit card business to be unsound or such companies fail to satisfy the guidelines or regulations, the Financial Services Commission may take certain measures to improve the financial condition of such companies.

**Table of Contents*****Restrictions on Scope of Business***

Under the Specialized Credit Financial Business Act, a credit card company may conduct only the following types of business: (i) credit card business as licensed or other specialized credit finance businesses as registered pursuant to the Specialized Credit Financial Business Act; (ii) the businesses ancillary to the credit card business, (for example, providing cash advance loans to existing credit card holders, issuing and settling of debit cards and issuing, selling and settling of pre-paid cards); (iii) provision of unsecured or secured loans; (iv) provision of discount on notes; (v) purchase, management and collection of account receivables originated by companies in the course of providing goods and services; (vi) provision of payment guarantee; (vii) asset management business under the Asset Backed Securitization Act; (viii) credit investigation; and (ix) other incidental businesses related to the foregoing. Under the Specialized Credit Financial Business Act, a credit card company's scope of business includes businesses that utilize existing manpower, assets or facilities in a credit card company, as designated by the Financial Services Commission. Under the current regulation established by the Financial Services Commission, a credit card company may engage in various types of business including, but not limited to, e-commerce, operation of insurance agency, delegation of card issuance, supply of payment settlement system, loan brokerage and brokerage of collective investment securities.

A credit card company's average balance of claim amounts arising from the advance of loans to credit card holders (excluding such claims arising from the re-advance of loans to credit card holders following a change in the maturity or interest rate of such loans as part of a debt restructuring) as of the end of each quarter may not exceed the sum of the following amounts:

Average balance of claims during a quarter arising from the purchase of goods or services by credit card holders with credit cards; and

Amount of debit card usage during a quarter by debit card members.

***Capital Adequacy***

The Specialized Credit Financial Business Act provides for a minimum paid-in capital amount of: (i) ₩20 billion in the case of a specialized credit financial business company which wishes to engage in no more than two kinds of core businesses (i.e. credit card, installment finance, leasing and new technology business) and (ii) ₩40 billion in the case of an specialized credit financial business company, which wishes to engage in three or more kinds of core businesses.

Under the Specialized Credit Financial Business Act and regulations thereof, a credit card company must maintain a capital adequacy ratio, defined as the ratio of adjusted equity capital to adjusted total asset, of 8% or more and a delinquent claim ratio, defined as the ratio of delinquent claims to total claims as set forth under the regulations relating to the Specialized Credit Financial Business Act, of less than 10%.

Under the Specialized Credit Financial Business Act and regulations thereof, the minimum ratio of allowances for losses on loans, leased assets (except assets subject to an operating lease) and suspense receivables as of the date of accounting settlement (including semiannual preliminary accounts settlement) would be 0.5% of normal assets, 1% of precautionary assets and 20% of substandard assets, 75% of doubtful assets and 100% of estimated loss assets, and the minimum ratio of allowances for losses on card assets would be 1.1% (or 2.5%, in the case of card loan assets and revolving assets) of normal assets, 40% (or 50%, in the case of card loan assets and revolving assets) of precautionary assets, 60% (or 65%, in the case of card loan assets and revolving assets) of substandard assets, 75% of doubtful assets and 100% of estimated loss assets. In addition, a credit card company has to reserve a certain amount calculated

according to relevant regulations as loss allowances for unused credit limits.

***Liquidity***

Under the Specialized Credit Financial Business Act and regulations thereunder, a credit card company must maintain a Won liquidity ratio (Won-denominated current assets/Won-denominated current liabilities) of 100%



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or more. In addition, once a credit card company is registered as a foreign exchange business institution with the Minister of the Ministry of Strategy and Finance, such credit card company is required to (1) maintain a foreign-currency liquidity ratio within three months (defined as foreign-currency liquid assets due within three months divided by foreign-currency liabilities due within three months) of not less than 80%, (2) maintain a ratio of foreign-currency liquid assets due within seven days (defined as foreign-currency liquid assets due within seven days less foreign-currency liabilities due within seven days, divided by total foreign-currency assets) of not less than 0% and (3) maintain a ratio of foreign-currency liquid assets due within a month (defined as foreign-currency liquid assets due within a month less foreign-currency liabilities due within a month, divided by total foreign-currency assets) of not less than negative 10%. The Financial Services Commission requires a credit card company to submit quarterly reports with respect to the maintenance of these ratios.

***Restrictions on Funding***

Under the Specialized Credit Financial Business Act, a credit card company may raise funds using only the following methods: (i) borrowing from financial institutions, (ii) issuing corporate debentures or notes, (iii) selling securities held by the credit card company, (iv) transferring claims held by the credit card company, (v) transferring claims held by the credit card company in connection with its businesses, or (vi) issuing securities backed by the claims held by the credit card company relating to its businesses.

Furthermore, a credit card company may borrow funds from offshore or issue foreign currency denominated securities once it is registered as a foreign exchange business institution with the Minister of the Ministry of Strategy and Finance.

A credit card company must ensure that its total asset does not exceed six times the amount of its equity capital. However, if the credit card company cannot comply with such limit due to the occurrence of unavoidable events such as drastic changes in the domestic and global financial markets, such limit of its total assets compared to the equity capital may be adjusted by a resolution of the Financial Services Commission. A non-credit card company must ensure that its total asset does not exceed ten times the amount of its equity capital.

***Restrictions on Loans to Affiliate Companies***

Under the Specialized Credit Financial Business Act and regulations thereof, a credit card company may not provide loans exceeding 100% of its equity capital, in the aggregate, to its specially related persons (as defined under the relevant laws) including, but not limited to, its affiliates.

***Restrictions on Assistance to Other Companies***

Under the Specialized Credit Financial Business Act, a credit card company may not engage in any of the following acts in conjunction with other financial institutions or companies: (i) holding voting shares under cross shareholding or providing credit for the purpose of avoiding the restrictions on loans to affiliate companies; (ii) acquiring shares under cross shareholding for the purpose of avoiding the limitation on purchase of its treasury shares under the Korean Commercial Code or the Financial Investment Services and Capital Markets Act; or (iii) other acts which are likely to have a material adverse effect on the interests of transaction parties as stipulated by the Presidential Decree to the Specialized Credit Financial Business Act, which are not yet provided.

A credit card company also may not extend credit for enabling another person to purchase the shares of such credit card company or to arrange financing for the purpose of avoiding the restrictions on loans to affiliate companies.

***Restrictions on Investment in Real Estate***

Under the Specialized Credit Financial Business Act and the regulations thereof, a credit card company may possess real estate only to the extent that such business conduct is designated by such laws and regulations, with

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certain exceptions such as for the purposes of factoring or leasing or as a result of enforcing its security rights, provided that the Financial Services Commission may limit the maximum amount a credit card company may invest in real estate investments for business purposes up to a percentage equal to or in excess of 100% of its equity capital.

***Restrictions on Shareholding in Other Companies***

Under the Specialized Credit Financial Business Act and the Act on the Structural Improvement of the Financial Industry, a credit card company and its affiliate financial institutions (together a group) are required to obtain prior approval of the Financial Services Commission if such credit card company, together with its affiliate financial institutions, (i) owns 20% or more of outstanding voting shares of a target company or (ii) owns 5% or more of outstanding voting shares of a target company, and shall be deemed to have control of the target company, including being the largest shareholder of such target company or otherwise.

***Disclosure and Reports***

Pursuant to the Specialized Credit Financial Business Act and the regulations thereof, the ordinary disclosure requirement for a credit card company is to disclose any material matters relating to management performance, profits and losses, corporate governance, competence of the employees or risk management within three months from the end of each fiscal year and within two months from the end of the first half of the fiscal year. In addition, a credit card company is required to disclose on an on-going basis certain matters such as the occurrence of non-performing loans, a financial incident or losses exceeding certain amounts. In addition, under the regulations issued by the Financial Services Commission, a credit card company or a licensed bank engaging in the credit card business must submit such report as required by the Governor of the Financial Supervisory Service, with certain important matters being reported as frequently as each month. In addition, all companies engaged in the specialized credit financial business under the Specialized Credit Financial Business Act, including, without limitation, credit card companies, must file a report to the Financial Supervisory Service regarding the result of settlement of accounts within one month after the end of its fiscal year. Also, these companies are required to conduct a provisional settlement of accounts for each quarter and file a report to the Financial Supervisory Service within one month after the end of such quarter.

***Risk of Loss Due to Lost, Stolen, Forged or Altered Credit Cards***

Under the Specialized Credit Financial Business Act, upon notice from the holder of a credit card or a debit card of its loss or theft, a credit card company or a licensed bank engaged in the credit card business, as the case may be, is liable for any loss arising from the unauthorized use of credit cards or debit cards thereafter as well as any loss from unauthorized transactions made within 60 days prior to such notice. However, a credit card company or a licensed bank engaged in the credit card business, as the case may be, may transfer to the cardholder all or part of the risks of loss associated with unauthorized transactions made within 60 days prior to such notice, in accordance with the standard terms and conditions agreed between the credit card company or the licensed bank engaged in the credit card business, as the case may be, and the cardholder, provided that the loss or theft must be due to the cardholder's willful misconduct or negligence. Disclosure of a cardholder's password under duress or threat to the cardholder's or his/her family's life or health will not be deemed as the cardholder's willful misconduct or negligence.

Moreover, a credit card company or a licensed bank engaged in the credit card business, as the case may be, is also responsible for any losses resulting from the use of forged or altered credit cards, debit cards and pre-paid cards. However, a credit card company or a licensed bank engaged in the credit card business, as the case may be, may transfer all or part of this risk of loss to holders of credit cards in the event of willful misconduct or gross negligence by holders of such cards if the terms and conditions of the written agreement entered between the credit card company or a licensed bank engaged in the credit card business, as the case may be, and holders of such cards specifically

provide for such transfer. For these purposes, disclosure of a customer's password that is made intentionally or through gross negligence, or the transfer of or giving as collateral of the credit card or debit card, is considered willful misconduct or gross negligence.

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In addition, the Specialized Credit Financial Business Act prohibits a credit card company from transferring to merchants the risk of loss arising from lost, stolen, forged or altered credit cards, debit cards or pre-paid cards; provided, however, that a credit card company may enter into an agreement with a merchant under which the merchant agrees to be responsible for such loss if caused by the merchant's gross negligence or willful misconduct.

Each credit card company or a licensed bank engaged in the credit card business must institute appropriate measures such as establishing reserves, purchasing insurance or joining a cooperative association in order to fulfill its obligations related to the risk of loss arising from unauthorized use due to lost, stolen, forged or altered credit cards, debit cards or pre-paid cards.

Under the Specialized Credit Financial Business Act, the Financial Services Commission may take necessary measures to maintain credit order and protect consumers by establishing standards to be complied with by credit card companies relating to:

maximum limits for cash advances on credit cards;

restrictions on debit cards with respect to per day or per transaction usage;

aggregate issuance limits and maximum limits on the amount per card on pre-paid cards;

calculation and determination of credit limits;

determination of the amount limit of credit cards;

provisions included in credit card agreements;

management of credit card merchants;

collection on claims; or

classification of credit card holders for purposes of determining the fees applicable to such holders.

***Lending Ratio in Ancillary Business***

Pursuant to the Presidential Decree of the Specialized Credit Financial Business Act, as amended in September 2013, a credit card company must maintain a quarterly average balance of receivables arising from cash advances to credit card holders (excluding cash advances incurred by re-lending to a credit card holder after modifying the terms and conditions, such as maturity or interest rate, of the original cash advance for debt rescheduling purposes) no greater than its aggregate quarterly average balance of receivables arising from credit card holders' purchase of goods and

services (excluding the amount of receivables arising from the purchase of goods and services using an exclusive use card for business purposes) plus its aggregate quarterly amount of payments made by members using their debit cards.

***Issuance of New Cards and Solicitation of New Card Holders***

The Presidential Decree of the Specialized Credit Financial Business Act establishes the conditions under which a credit card company or a licensed bank engaged in the credit card business may issue new cards and solicit new members. Specifically, new credit cards may be issued only to the following persons that meet all of the following criteria: (i) age of 19 years or more as defined in the Korean Civil Code, or age of 18 years or more with evidence of employment as of the date of the credit card application; (ii) satisfaction of a minimum credit score as publicly announced by the Financial Services Commission, provided that the minimum personal credit score requirement will not apply in the case where (a) the credit card company can confirm through objective evidence that an applicant is sufficiently capable of paying for his or her credit card use or such applicant can provide objective evidence therefor, or (b) a credit card function is added to an existing debit card for added convenience to the card holder and the credit card function is subject to limits determined by the Financial Services Commission and (iii) satisfaction of the application scoring system for the relevant credit; and (iv) verification of personal identity.

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In addition, a credit card company or a licensed bank engaged in the credit card business, as the case may be, may not engage in the following methods of soliciting credit card holders: (i) providing economic benefits or conditioning such benefits in excess of 10% of the annual credit card fee (in the case of no-annual fee credit cards, the average annual fees will be ₩10,000) in connection with issuance of credit cards; (ii) solicitation on streets and private roads as prescribed under the Road Act and Private Road Act, public place and corridors used by the general public; (iii) solicitation through visits, except those visits made upon prior consent and visits to a business area; (iv) solicitation through pyramid sales methods; and (v) solicitation through the Internet, as further discussed below.

In addition, a credit card company or a licensed bank engaged in the credit card business is required to check whether the credit card applicant has any delinquent debt owed to any other credit card company or other financial institutions which the applicant is unable to repay, and also require, in principle, with respect to solicitations made through the Internet, the certified electronic signature of the applicant. Moreover, persons who intend to engage in solicitation of credit card applicants must register with the Financial Services Commission, unless the solicitation is made by officers or employees of a credit card company or a company in business alliance with such credit card company.

### ***Compliance Rules on Collection of Receivable Claims***

Pursuant to the Specialized Credit Financial Business Act and its regulations, a credit card company or a licensed bank engaged in the credit card business are prohibited from collecting its claims by way of:

exerting violence or threat of violence;

informing a Related Party (a guarantor of the debtor, blood relative or fiancée of the debtor, a person living in the same household as the debtor or a person working in the same workplace as the debtor) of the debtor's liability without just cause;

providing false information relating to the debtor's obligation to the debtor or his or her Related Party;

threatening to sue or suing the debtor for fraud despite lack of affirmative evidence to establish that the debtor has submitted forged or false documentation with respect to his/her capacity to make payment;

visiting or telephoning the debtor during late hours between 9:00 p.m. and 8:00 a.m.; and

utilizing other uncustomary methods to collect the receivables thereby invading the privacy or the peacefulness in the workplace of the debtor or his or her Related Party.

### **Principal Regulations Applicable to Financial Investment Companies**

#### ***General***

The securities business is regulated and governed by the Financial Investment Services and Capital Markets Act. Financial investment companies are under the regulation and supervision of the Financial Services Commission, the

Financial Supervisory Service and the Securities and Futures Commission.

Under the Financial Investment Services and Capital Markets Act, a financial investment company may engage in dealing, brokerage, collective investment, investment advice, discretionary investment management or trust businesses if it has obtained relevant licenses from the Financial Services Commission.

A financial investment company may also engage in certain businesses ancillary to the primary business or certain other additional businesses by submitting a report to the Financial Services Commission at least seven days prior to the commencement of the business without obtaining any separate license. Approval to merge with any other entity or to transfer all or substantially all of a business must also be obtained from the Financial Services Commission.



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Under the Act on the Structural Improvement of the Financial Industry, if the Korean government deems a financial investment company's financial condition to be unsound or if a financial investment company fails to meet the applicable Net Operating Equity Ratio (as defined below), the government may order certain sanctions, including among others, sanctions against a financial investment company or its officers or employees, capital increase or reduction and a suspension or assignment of a part or all of business operation.

***Regulations on Financial Soundness – Capital Adequacy***

The Financial Investment Services and Capital Markets Act sets forth various types of brokerage and/or dealing business licenses based on (i) the scope of products and services that may be provided by each type of the brokerage and/or dealing licensee and (ii) the type of customers to which such products and services may be provided. For example, a financial investment company engaged in the brokerage, dealing and underwriting businesses with retail investors as well as professional investors in connection with all types of securities is required to have a minimum paid-in capital of ₩53 billion in order to obtain a license for such brokerage, dealing and underwriting businesses.

Under the Financial Investment Service Regulations, as amended effective as of December 12, 2014, the soundness requirement of financial investment companies changed from the previous net operating equity ratio requirement to a net equity ratio requirement. The net equity ratio is calculated according to the following formula:

Net Equity Ratio = (Net Operating Equity – Total Risk) / Equity Capital Maintenance Requirement for Each Service Unit

The terms "Net Operating Equity" and "Total Risk" for the purpose of the above-stated formula are defined and elaborated in the regulations of the Financial Services Commission. Generally, the Net Operating Equity, the Total Risk and the Equity Capital Maintenance Requirement for Each Service Unit are to be calculated according to the following formula:

Net Operating Equity = Net assets (total assets – total liabilities) – the total of items that may be deducted + the total of items that may be added;

Total Risk = market risk + counterparty risk + management risk; and

Equity Capital Maintenance Requirement for Each Service Unit = Mandatory Equity Capital to be Required for Each Licensed Service Unit × 70%

The regulations of the Financial Services Commission requires, among other things, financial investment companies to maintain the net equity ratio at a level equal to or higher than 100% at the end of the each quarter of the fiscal year.

In addition, all Korean companies, including financial investment companies, are required to set aside, as a legal reserve, 10% of the cash portion of the annual dividend or interim dividend in each fiscal year until the reserve reaches 50% of the stated capital.

Under the Financial Investment Services and Capital Markets Act and regulations thereunder, the minimum ratio of allowances for losses on loans and suspense receivables specified under such regulations is 0.5% of normal assets, 2% of precautionary assets, 20% of substandard assets, 75% of doubtful assets and 100% of estimated loss assets.



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### ***Other Provisions on Financial Soundness***

The Financial Investment Services and Capital Markets Act, the Presidential Decree of the Financial Investment Services and Capital Markets Act and the regulations of the Financial Services Commission also include certain provisions which are designed to regulate certain types of activities relating to the management of the assets of a securities company, subject to certain exceptions. Such provisions include:

restrictions on the holdings by a securities company of securities issued by another company which is the largest shareholder or the major shareholder (each as defined under the Financial Investment Services and Capital Markets Act) of such securities company; and

restrictions on providing money or credit to the largest shareholder (including specially-related persons of such shareholder), major shareholders, officers and specially-related persons of the securities company.

### **Principal Regulations Applicable to Insurance Companies**

#### ***General***

Insurance companies are regulated and governed by the Insurance Business Act, as amended (the Insurance Business Act). In addition, insurance companies in Korea are under the regulation and supervision of the Financial Services Commission and its governing entity, the Financial Supervisory Service.

Under the Insurance Business Act, approval to commence an insurance business must be obtained from the Financial Services Commission based on the type of insurance businesses, which are classified as life insurance business, non-life insurance business and third type insurance business. Life insurance business means an insurance business which deals with life insurance policies or pension insurance policies (including retirement insurance policies). Non-life insurance business means an insurance business which deals with fire insurance policies, marine insurance policies, car insurance policies, guaranty insurance policies, reinsurance policies, liability insurance policies or other insurance policies prescribed under the Presidential Decree of the Insurance Business Act. Third type insurance business means an insurance business which deals with injury insurance policies, health insurance policies or nursing care insurance policies. Under the Insurance Business Act, insurance companies are not allowed to engage in both a life insurance business and a non-life insurance business, subject to certain exceptions.

If the Korean government deems an insurance company's financial condition to be unsound or if an insurance company fails to properly manage the business as set forth under relevant Korean law, the government may order certain sanctions including, among others, sanctions against an insurance company or its officers or employees, capital increase or reduction and a suspension or assignment of a part or all of business operation.

#### ***Capital Adequacy***

The Insurance Business Act requires a minimum paid-in capital of ₩30 billion for an insurance company; provided, that, the insurance company which intends to engage in only certain types of insurance policies may have a lower paid-in capital pursuant to the Presidential Decree of the Insurance Business Act.

In addition to the minimum capital requirement, an insurance company is required to maintain a Solvency Margin Ratio of 100% or more. Solvency Margin Ratio is the ratio of the Solvency Margin to the Standard Amount of the

Solvency Margin. Solvency Margin is the aggregate amount of paid-in capital, reserve for dividends to policyholders, allowance for bad debt and subordinated debt amount and others similar thereto as set out in the regulation of the Financial Services Commission, less non-amortized acquisition costs, goodwill and others similar thereto as appearing in the regulation of the Financial Services Commission. The Standard Amount of Solvency Margin for life insurance companies is defined under the regulation of the Financial Services Commission and is required to comply with the risk based capital regime.

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Under the Insurance Business Act, the Presidential Decree and other regulations thereunder, for each accounting period, insurance companies are required to appropriate policy reserve that is earmarked for future payments of insurance money, refund and dividends to policyholders (hereinafter collectively referred to as Insurance Money ) for each insurance contract. However, if an insurance company has reinsured a portion of its insurance contracts with a creditworthy reinsurance company in order to lower its overall risk, in principle, the insurance company is not required to appropriate policy reserve for the reinsured contracts. Instead, the reinsurance company is required to appropriate such policy reserve for the reinsured contracts. However, if an insurance company transfers more than 50% of its risk to a reinsurance company, the amount of risk transferred in excess of 50% will be disallowed for purposes of calculating the solvency margin ratio. In particular, if the ratio of the risks transferred to the reinsurance company to the total risks insured by an insurance company exceeds 50%, such insurance company will be required to have net assets in relation to such risks transferred in excess of the 50% threshold for purposes of the solvency margin requirement. The Insurance Business Act was amended on January 24, 2011 to classify the insurance products into two categories: (i) reportable insurance products and (ii) voluntary insurance products. Under this amendment, only the changes to the terms and conditions of the reportable insurance products require a prior report and approval from the Financial Supervisory Service and the voluntary insurance products can be sold without prior approval from the Financial Supervisory Service. The policy reserve needs to be appropriated in accordance with the policy reserve calculation method for each insurance product as stipulated in amended Insurance Business Act.

The policy reserve amount consists of the following: (i) premium reserves and prepaid insurance premiums which are calculated under the methods determined by the written calculation methods for insurance premiums and policy reserves by insurance types or by lapses of insurance period, with regard to the contracts for which the causes for payment of the Insurance Money have yet to occur as of the end of each accounting period; (ii) amounts for which a lawsuit is pending on the Insurance Money or amounts for which a payment has been fixed with regard to the contracts for which the causes for payment of Insurance Money have occurred as of the end of each accounting period, and amounts which have not been paid yet due to an unsettled amount for paying the Insurance Money, even if the causes for payment of the Insurance Money have already occurred; and (iii) amounts reserved by an insurance company for allocation to policyholders.

Pursuant to the regulations established by the Financial Services Commission, insurance companies are required to maintain allowances for outstanding loans, accounts receivables and other credits (including accrued income, payment on account, and bills receivables or dishonored) in an aggregate amount covering not less than 0.5% of normal credits, 2% of precautionary credits, 20% of substandard credits, 50% of doubtful credits and 100% of estimated loss credits, provided that the minimum ratio of allowances for certain type of outstanding loans by insurance companies to individuals and households (including, retail loans, housing loans, and other forms of retail loans extended to individuals not registered for business), is increased to 1% of normal credits, 10% of precautionary credits and 55% of doubtful credits . Furthermore, the regulations on insurance companies became more stringent in September 2010 by adding a requirement that insurance companies maintain allowance for bad debts in connection with real estate project financing loans in excess of 0.9% of normal credits and 7% of precautionary credits.

***Variable Insurance and Bancassurance Agents***

Variable insurance is regulated pursuant to the Insurance Business Act and the Financial Investment Services and Capital Markets Act. In order for an insurance company to sell variable insurance to a policyholder and operate such variable insurance, the insurance company must obtain a license with respect to collective investment business from the Financial Services Commission and register as a selling company with the Financial Services Commission. In this case, according to the Financial Investment Services and Capital Markets Act, an insurance company will be regulated as an investment trust and assets acquired in connection with variable insurance must be held by a trust company that is registered with the Financial Services Commission pursuant to the Financial Investment Services and Capital

Markets Act.

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According to the Financial Investment Services and Capital Markets Act, insurance companies may operate variable insurance through (i) mandating all of the management and the management instruction business to another asset management company, (ii) operating by way of discretionary investment all of the assets constituting the investment advisory assets out of the investment trust assets, or (iii) operating all of the investment trust assets into other collective investment securities, thereby allowing all of the particular variable insurance assets to be outsourced.

The Insurance Business Act permits banks, securities companies, credit card companies and other financial institutions to register as insurance agents or insurance brokers and engage in the insurance business (the Bancassurance Agents ), who are currently permitted to sell all types of life and non-life insurance products, except for protection type insurance products, such as whole life insurance, critical illness insurance and automobile insurance.

### ***Restrictions on Investment of Assets***

According to the Insurance Business Act, insurance companies are prohibited from making any of the following investment of assets:

owning any real estate (excluding any real estate owned as a result of enforcing their own security interest) other than real estate for conducting its business as designated by the Presidential Decree. In any case, the total amount of real estate owned by an insurance company must not exceed 15% of its Total Assets, provided that investment in real estate for a separate account is limited to 15% of the assets of such separate account;

loans made for the purpose of speculation in commodities or securities;

loans made directly or indirectly to enable a natural or legal person to buy their own shares;

loans made directly or indirectly to finance political campaigns and other similar activities; and

loans made to any of the insurance company's officers or employees other than loans based on insurance policy or de minimis loans of up to (1) ₩20 million in the case of a general loan, (2) ₩50 million in the case of a general loan plus a housing loan, or (3) ₩60 million in the aggregate for general loans, housing loans and loans to pay damages arising from wrongful acts of employees in financial transactions.

In addition, insurance companies are not allowed to exceed the following limits in making the following investments:

with respect to holding foreign currency under the Foreign Exchange Transaction Act or owning offshore real estate, 30% of its Total Assets; and

with respect to the sum of margins for a futures exchange designated by the Presidential Decree or a foreign futures exchange, and commitment amounts of over-the-counter derivatives must not exceed 6% of its Total

Assets, provided that the over-the-counter derivative trades are limited to 3%. The derivatives trades of a separate account are limited to 6% of the assets of separate account, provided that the over-the-counter derivatives trades are limited to 3%.

***Regulations on Class Actions Regarding Securities***

The Law on Class Actions Regarding Securities was enacted as of January 20, 2004 and last amended on May 28, 2013. The Law on Class Actions Regarding Securities governs class actions suits instituted by one or more representative plaintiff(s) on behalf of 50 or more persons who claim to have been damaged in a capital markets transaction involving securities issued by a listed company in Korea.



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Applicable causes of action with respect to such suits include:

claims for damages caused by misleading information contained in a securities statement;

claims for damages caused by the filing of a misleading business report, semi-annual report, or quarterly report;

claims for damages caused by insider trading or market manipulation; and

claims instituted against auditors for damages caused by accounting irregularities.

Any such class action may be instituted upon approval from the presiding court and the outcome of such class action will have a binding effect on all potential plaintiffs who have not joined the action, with the exception of those who have filed an opt out notice with such court.

## **U.S. Regulations**

As substantially all of our, and our subsidiaries', operations are in Korea, we are primarily subject to the regulations and supervision of the Financial Services Commission and the Financial Supervisory Service. Our subsidiaries, however, have limited operations in the United States, and we own a bank in the United States. Therefore, we and our U.S. operations are subject to U.S. supervision, regulation and enforcement by relevant authorities in the United States with regard to our U.S. operations.

### ***U.S. Banking Regulations***

Our operations in the United States are subject to a variety of regulatory regimes. Shinhan Bank maintains an uninsured branch in New York, which is licensed by the New York State Department of Financial Services ( Department ) and registered with the banking authority of Korea. Shinhan Bank's New York branch is subject to regulation and examination by the Department under its licensing authority. In addition, the Board of Governors of the Federal Reserve System (the Federal Reserve ) exercises examination and regulatory authority over Shinhan Bank's U.S. branch. We also own a non-member state chartered bank, Shinhan Bank America, which is regulated by the Department, as its chartering authority, and by the Federal Deposit Insurance Corporation ( FDIC ), as its primary federal banking regulator and as the insurer of its deposits. Our U.S. branch and U.S. bank subsidiary are subject to restrictions on their respective activities, as well as prudential restrictions, such as limits on extensions of credit to a single borrower, and restrictions on transactions with affiliates, among other things. We are also a financial holding company and a bank holding company under U.S. banking laws and our U.S. operations are subject to regulation, supervision and enforcement by the Federal Reserve.

#### ***Shinhan Bank's U.S. Branch***

The Department, as the licensing authority of Shinhan Bank's U.S. branch, has the authority, in certain circumstances, to take possession of the business and property of Shinhan Bank located in New York. Such circumstances generally include violations of law, unsafe business practices and insolvency. If the Department exercised this authority over the New York branch of Shinhan Bank, all assets of Shinhan Bank located in New York would generally be applied first

to satisfy creditors of the New York branch. Any remaining assets would be applied to satisfy creditors of other U.S. offices of Shinhan Bank, after which any residual assets of the New York branch would be returned to the principal office of Shinhan Bank, and made available for application pursuant to any Korean insolvency proceeding.

*Financial Holding Company*

Because we operate a U.S. branch and have a subsidiary bank in the U.S., our nonbanking activities in the United States are subject to regulation by the Federal Reserve pursuant to the International Banking Act of 1978, the Bank Holding Company Act of 1956 (the BHC Act ), and other laws. We have elected to be a financial

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holding company under the BHC Act. Financial holding companies may engage in a broader spectrum of activities than bank holding companies or foreign banking organizations that are not financial holding companies, including underwriting and dealing in securities. To maintain our financial holding company status, (i) we and our U.S. subsidiary bank located in New York are required to be well capitalized and well managed, (ii) our U.S. branch and our U.S. subsidiary bank located in New York are required to meet certain examination ratings, and (iii) our subsidiary bank in New York is required to maintain a rating of at least satisfactory under the Community Reinvestment Act of 1977 (the CRA).

A major focus of U.S. governmental policy relating to financial institutions in recent years has been aimed at fighting money laundering and terrorist financing. Regulations applicable to us and our subsidiaries impose obligations to maintain effective policies, procedures and controls to detect, prevent and report money laundering and terrorist financing and to verify the identities of clients. Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing could have serious consequences for the firm, both in legal terms and in terms of our reputation.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the Dodd-Frank Act), which was enacted on July 21, 2010 in response to the financial crisis, impacts the financial services industry by addressing, among other issues, systemic risk oversight, bank capital standards, the liquidation of failing systemically important institutions, OTC derivatives, the ability of banking entities, including non-U.S. banks with branches in the U.S., like us, to engage in proprietary trading activities and invest in hedge funds and private equity (the so-called Volcker rule), consumer and investor protection, hedge fund registration, securitization, investment advisors, shareholder say on pay, the role of credit-rating agencies, and more. The Dodd-Frank Act requires various federal banking and financial regulatory authorities to adopt a broad range of implementing rules and regulations. Such authorities have significant discretion in drafting the implementing rules and regulations and, consequently, the full impact of the Dodd-Frank Act may not be known for years.

The Dodd-Frank Act provides regulators with tools to impose greater capital, leverage and liquidity requirements and other prudential standards, particularly for financial institutions that pose significant systemic risk and bank holding companies with greater than \$50 billion in assets. In imposing such heightened prudential standards on non-U.S. banks such as us, the Federal Reserve Board is directed to take into account the principle of national treatment and equality of competitive opportunity, and the extent to which the foreign bank holding company is subject to comparable home country standards. In February 2014, the Federal Reserve Board issued final rules applying enhanced prudential standards to foreign banking organizations, or FBOs, like us with \$50 billion or more in total global consolidated assets. The final rules represent significant changes to the way that the U.S. operations of FBOs are supervised by the Federal Reserve within the United States. In particular, the final rules:

require an FBO with both \$50 billion or more in total global consolidated assets and combined U.S. assets (excluding the total assets of each U.S. branch and agency) of \$50 billion or more to establish a U.S. top-tier intermediate holding company (IHC) over all U.S. bank and nonbank subsidiaries subject to the proposal;

subject an FBO's IHC to the same capital adequacy standards, including minimum risk based capital and leverage requirements, as those applicable to U.S. bank holding companies;

require an FBO with combined U.S. assets of \$50 billion or more to have its U.S. operations satisfy certain liquidity risk management standards, conduct liquidity stress tests, and maintain a buffer of highly liquid assets over specified time horizons, and an FBO with combined U.S. assets of less than \$50 billion would be required to conduct an internal liquidity stress test and report the results to the Federal Reserve Board on an annual basis; and

subject the largest FBOs with the most significant U.S. operations (i.e., those FBOs with \$50 billion or more in total global consolidated assets and \$50 billion or more in combined U.S. assets, excluding the assets of their U.S. branch and agency networks) to heightened compliance obligations with respect to capital plans, capital and leverage standards, capital stress testing, liquidity stress testing and risk management.

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The final rules also include requirements relating to overall risk management and debt-to-equity limits for the U.S. operations of FBOs. Implementation of the final rules began June 1, 2014 with the most significant requirements to be implemented beginning July 1, 2016. Rules imposing single counterparty credit limits and early remediation requirements on FBOs have yet to be finalized. We are currently assessing the full impact of these enhanced prudential requirements on our business.

*Shinhan Bank America*

Shinhan Bank America, a state chartered bank that is located in New York and is not a member of the Federal Reserve, is subject to extensive regulation and examination by the Department, as its chartering authority, and by the FDIC, as the insurer of its deposits and as its primary federal banking regulator. The federal and state laws and regulations which are applicable to banks regulate, among other things, the activities in which they may engage and the locations at which they may engage in them, their investments, their reserves against deposits, the timing of the availability of deposited funds and transactions with affiliates, among other things. Shinhan Bank America must file reports with the Department and the FDIC concerning its activities and financial condition, in addition to obtaining regulatory approvals prior to entering into certain transactions, such as establishing branches and mergers with, or acquisitions of, other depository institutions. The Department and the FDIC periodically examine the bank to test Shinhan Bank America's safety and soundness and its compliance with various regulatory requirements. This comprehensive regulatory and supervisory framework restricts the activities in which a bank can engage and is intended primarily for the protection of the FDIC insurance fund and the bank's depositors. The regulatory structure also gives the regulatory authorities extensive discretion in connection with their supervisory and enforcement activities and examination policies, including policies with respect to the classification of assets and the establishment of adequate loan loss reserves. Any change in such regulations, whether by the Department, the FDIC or as a result of the enactment of legislation, could have a material adverse impact on Shinhan Bank America and its operations.

*Capital Requirements.* The FDIC imposes capital adequacy standards on state-chartered banks like Shinhan Bank America. In order to be considered "adequately capitalized", the FDIC's current capital regulations require a minimum 3.0% Tier I leverage capital requirement for the most highly-rated state-chartered, non-member banks, with an additional cushion of at least 100 basis points required for all other state-chartered, non-member banks, which effectively will increase the minimum Tier I leverage ratio for such other banks to 4.0%. Under the FDIC's regulation, the highest-rated banks are those that the FDIC determines are not anticipating or experiencing significant growth and have well diversified risk, including no undue interest rate risk exposure, excellent asset quality, high liquidity, good earnings and, in general, which are considered a strong banking organization and are rated composite 1 under the Uniform Financial Institutions Rating System. Tier I or core capital is defined as the sum of common stockholders equity (including retained earnings), non-cumulative perpetual preferred stock and related surplus, and minority interests in consolidated subsidiaries, minus all intangible assets other than certain qualifying supervisory goodwill and certain mortgage servicing rights.

The FDIC also requires that banks meet a risk-based capital standard. The current risk-based capital standard for banks requires, in order to be "adequately capitalized", the maintenance of a ratio of total capital (which is defined as Tier I capital and supplementary capital) to risk-weighted assets of 8.0% and Tier I capital to risk-weighted assets of 4%. In determining the amount of risk-weighted assets, all assets, plus certain off-balance sheet assets, are multiplied by a risk-weight of 0% to 100%, based on the risks the FDIC believes are inherent in the type of asset or item. The components of Tier I capital are the same as for the leverage capital standard. The components of supplementary capital include certain perpetual preferred stock, certain mandatory convertible securities, certain subordinated debt and intermediate preferred stock and general allowances for loan and lease losses. Allowance for loan and lease losses includable in supplementary capital is limited to a maximum of 1.25% of risk-weighted assets. Overall, the amount of capital counted toward supplementary capital cannot exceed 100% of core capital.

In order for our U.S. bank subsidiary to be classified as well capitalized , which is necessary in order for us to maintain our financial holding company status, it must have a Tier I leverage ratio of at least 5%, a Tier I risk-

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based capital ratio of at least 6% and a total risk-based capital ratio of at least 10%. Furthermore, banks are generally encouraged to maintain even higher levels of capital during the current period of economic difficulty.

As of December 31, 2014, Shinhan Bank America exceeded all of the capital ratio standards for a well capitalized bank with a Tier I leverage ratio of 13.41%, a Tier I risk-based capital ratio of 18.83% and a total risk-based capital ratio of 20.80%.

The current FDIC capital adequacy guidelines will be modified in accordance with Basel III. In July 2013, the Federal Reserve, the FDIC and the Office of the Comptroller of the Currency issued final rules (the Final Rules) that substantially revise the federal banking agencies' current capital rules and implement Basel III. The Final Rules, among other things, narrow the definition of capital, and increase capital requirements for specific exposures. They also include higher capital ratio requirements. In addition, consistent with the Dodd-Frank Act, they remove references to, or requirements of reliance on, credit ratings in the capital rules and replace them with alternative standards of creditworthiness. Shinhan Bank America has been subject to the Final Rules since January 1, 2015 and its current capital ratios satisfy the requirements set forth in the Final Rules.

*Activities and Investments of New York-Chartered Banks.* Shinhan Bank America derives its lending, investment and other authority primarily from the applicable provisions of New York State Banking Law and the regulations of the Department, as well as FDIC regulations and other federal laws and regulations. See *Activities and Investments of FDIC-Insured State-Chartered Banks* below. These New York laws and regulations authorize Shinhan Bank America to invest in real estate mortgages, consumer and commercial loans, certain types of debt securities, including certain corporate debt securities and obligations of federal, State and local governments and agencies, and certain other assets. A bank's aggregate lending powers are not subject to percentage of asset limitations, but, as discussed below, there are limits on the amount of credit exposure that a bank may have to a single borrower or group of related borrowers. A New York-chartered bank may also exercise trust powers upon approval of the Department. Shinhan Bank America does not have trust powers.

With certain limited exceptions, Shinhan Bank America may not make loans or extend credit for commercial, corporate or business purposes (including lease financing) to a single borrower, the aggregate amount of which would be in excess of 15% of Shinhan Bank America's net worth, on an unsecured basis, and 25% of the net worth if the excess is collateralized by readily marketable collateral or collateral otherwise having a value equal to the amount by which the loan exceeds 15% of Shinhan Bank America's net worth. In calculating the amount of outstanding loans or credit to a particular borrower for this purpose, Shinhan Bank America must include its credit exposure arising from derivative transactions with that borrower.

*Activities and Investments of FDIC-Insured State-Chartered Banks.* The activities and equity investments of FDIC-insured, state-chartered banks are generally limited to those that are permissible for national banks. Under regulations dealing with equity investments, an insured state bank generally may not directly or indirectly acquire or retain any equity investment of a type, or in an amount, that is not permissible for a national bank. An insured state bank may, among other things, (i) acquire or retain a majority interest in a subsidiary that is engaged in activities that are permissible for the bank itself to engage in, (ii) invest as a limited partner in a partnership the sole purpose of which is direct or indirect investment in the acquisition, rehabilitation or new construction of a qualified housing project, provided that such limited partnership investments may not exceed 2% of the bank's total assets, and (iii) acquire up to 10% of the voting stock of a company that solely provides or reinsures directors', trustees' and officers' liability insurance coverage or bankers' blanket bond group insurance coverage for insured depository institutions. In addition, an FDIC-insured state-chartered bank may not directly, or indirectly through a subsidiary, engage as principal in any activity that is not permissible for a national bank unless the FDIC has determined that such activities would pose no risk to the insurance fund of which it is a member and the bank is in compliance with

applicable regulatory capital requirements.

*Regulatory Enforcement Authority.* Applicable banking laws include substantial enforcement powers available to federal banking regulators. This enforcement authority includes, among other things, the ability to assess civil money penalties, to issue cease-and-desist or removal orders and to initiate injunctive actions against



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banking organizations and institution-affiliated parties, as defined. In general, these enforcement actions may be initiated for violations of laws and regulations and unsafe or unsound practices. Other actions or inactions may provide the basis for enforcement action, including misleading or untimely reports filed with regulatory authorities.

Under the New York State Banking Law, the Department may issue an order to a New York-chartered banking institution to appear and explain an apparent violation of law, to discontinue unauthorized or unsafe practices and to keep prescribed books and accounts. Upon a finding by the Department that any director, trustee or officer of any banking organization has violated any law, or has continued unauthorized or unsafe practices in conducting the business of the banking organization after having been notified by the Department to discontinue such practices, such director, trustee or officer may be removed from office by the Department after notice and an opportunity to be heard. The Department also may take possession of a banking organization under specified statutory criteria.

*Prompt Corrective Action.* Section 38 of the Federal Deposit Insurance Act ( FDIA ) provides the federal banking regulators with broad power to take prompt corrective action to resolve the problems of undercapitalized institutions. The extent of the regulators powers depends on whether the institution in question is well capitalized , adequately capitalized , undercapitalized , significantly undercapitalized or critically undercapitalized . A bank is deemed to be (i) well capitalized if it has total risk-based capital ratio of 10.0% or more, has a Tier I risk-based capital ratio of 6.0% or more, has a Tier I leverage capital ratio of 5.0% or more and is not subject to specified requirements to meet and maintain a specific capital level for any capital measure, (ii) adequately capitalized if it has a total risk-based capital ratio of 8.0% or more, a Tier I risk-based capital ratio of 4.0% or more and a Tier I leverage capital ratio of 4.0% or more (3.0% under certain circumstances) and does not meet the definition of well capitalized , (iii) undercapitalized if it has a total risk-based capital ratio that is less than 8.0%, a Tier I risk-based capital ratio that is less than 4.0% or a Tier I leverage capital ratio that is less than 4.0% (3.0% under certain circumstances), (iv) significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, a Tier I risk-based capital ratio that is less than 3.0% or a Tier I leverage capital ratio that is less than 3.0%, and (v) critically undercapitalized if it has a ratio of tangible equity to total assets that is equal to or less than 2.0%. The regulations also provide that a federal banking regulator may, after notice and an opportunity for a hearing, reclassify a well capitalized institution as adequately capitalized and may require an adequately capitalized institution or an undercapitalized institution to comply with supervisory actions as if it were in the next lower category if the institution is in an unsafe or unsound condition or engaging in an unsafe or unsound practice. The federal banking regulator may not, however, reclassify a significantly undercapitalized institution as critically undercapitalized.

An institution generally must file a written capital restoration plan which meets specified requirements, as well as a performance guaranty by each company that controls the institution, with an appropriate federal banking regulator within 45 days of the date that the institution receives notice or is deemed to have notice that it is undercapitalized, significantly undercapitalized or critically undercapitalized. Immediately upon becoming undercapitalized, an institution becomes subject to statutory provisions, which, among other things, set forth various mandatory and discretionary restrictions on the operations of such an institution.

*FDIC Insurance.* Shinhan Bank America is a member of the FDIC. As insurer, the FDIC is authorized to conduct examinations of, and to require reporting by, FDIC-insured institutions. It also may prohibit any FDIC-insured institution from engaging in any activity the FDIC determines by regulation or order to pose a serious threat to the FDIC.

In the past four years, there have been many failures and near-failures among financial institutions, although such failures have been declining in the United States in recent years. The FDIC insurance fund reserve ratio, representing the ratio of the fund to the level of insured deposits, declined due to losses caused by bank failures and the FDIC then increased its deposit insurance premiums on remaining institutions in order to replenish the insurance fund. The FDIC

insurance fund balance increased throughout 2010 and turned positive in 2011. The

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Dodd-Frank Act requires the FDIC to increase the ratio of the FDIC insurance fund to estimated total insured deposits to 1.35% by September 30, 2020. If bank failures in the future are more costly than the FDIC currently anticipates, then the FDIC will be required to continue to impose higher insurance premiums. Such an increase would increase our non-interest expense. Thus, despite the prudent steps Shinhan Bank America may take to avoid the mistakes made by other banks, its costs of operations may increase as a result of those mistakes by others.

As required by the Dodd-Frank Act, the FDIC revised its deposit insurance premium assessment rates in 2011. In general, the rates are applied to a bank's total assets less tangible capital, in contrast to the former rule which applied the assessment rate to a bank's amount of deposits. The FDIC believes that while the largest banks will face higher assessments under the new system than they would under the former system, most banks, including Shinhan Bank America, will pay a lower total assessment under the new system than they would have paid under the former system.

As a result of the Dodd-Frank Act, the increase in the standard FDIC insurance limit from \$100,000 to \$250,000 was made permanent. Since the Dodd-Frank Act also authorized banks to pay interest on commercial demand deposits, commercial depositors currently must choose between earning interest on their demand deposits or having the benefit of unlimited deposit insurance coverage.

The FDIC may terminate the deposit insurance of any insured depository institution, including Shinhan Bank America, if it determines, after a hearing, that the institution has engaged or is engaging in unsafe or unsound practices, is in an unsafe or unsound condition to continue operations, or has violated any applicable law, regulation, order or any condition imposed by an agreement with the FDIC. It also may suspend deposit insurance temporarily during the hearing process for the permanent termination of insurance, if the institution has no tangible capital. If insurance of accounts is terminated, the accounts at the institution at the time of the termination, less subsequent withdrawals, shall continue to be insured for a period of six months to two years, as determined by the FDIC. Management is aware of no existing circumstances that would result in termination of Shinhan Bank America's deposit insurance.

*Brokered Deposits.* Under federal law and applicable regulations, (i) a well capitalized bank may solicit and accept, renew or roll over any brokered deposit without restriction, (ii) an adequately capitalized bank may not accept, renew or roll over any brokered deposit unless it has applied for and been granted a waiver of this prohibition by the FDIC and (iii) an undercapitalized bank may not (x) accept, renew or roll over any brokered deposit or (y) solicit deposits by offering an effective yield that exceeds by more than 75 basis points the prevailing effective yields on insured deposits of comparable maturity in such institution's normal market area or in the market area in which such deposits are being solicited. The term "undercapitalized insured depository institution" is defined to mean any insured depository institution that fails to meet the minimum regulatory capital requirement prescribed by its appropriate federal banking agency. The FDIC may, on a case-by-case basis and upon application by an adequately capitalized insured depository institution, waive the restriction on brokered deposits upon a finding that the acceptance of brokered deposits does not constitute an unsafe or unsound practice with respect to such institution. Shinhan Bank America had an aggregate amount of US\$5 million of brokered deposits outstanding at December 31, 2014.

*Community Reinvestment and Consumer Protection Laws.* In connection with its lending activities, Shinhan Bank America is subject to a variety of federal laws designed to protect borrowers and promote lending to various sectors of the economy and population. Included among these are the Home Mortgage Disclosure Act, Real Estate Settlement Procedures Act, Truth-in-Lending Act, Equal Credit Opportunity Act, Fair Credit Reporting Act and CRA.

The CRA requires FDIC insured banks to define the assessment areas that they serve, identify the credit needs of those assessment areas and take actions that respond to the credit needs of the community. The FDIC must conduct regular CRA examinations of Shinhan Bank America and assign it a CRA rating of "outstanding,"



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satisfactory, needs improvement or unsatisfactory. Shinhan Bank America is also subject to provisions of the New York State Banking Law which impose similar obligations to serve the credit needs of its assessment areas. The Department and the FDIC each periodically assess a bank's compliance, and make the assessment available to the public. Federal and New York State laws both require consideration of these ratings when reviewing a bank's application to engage in certain transactions, including mergers, asset purchases and the establishment of branch offices. A negative assessment may serve as a basis for the denial of any such application. Shinhan Bank America has received satisfactory ratings from both the Department and the FDIC.

The Dodd-Frank Act created a new federal Consumer Financial Protection Bureau ( Bureau ) with broad authority to regulate and enforce consumer protection laws. The Bureau has the authority to adopt regulations under numerous existing federal consumer protection statutes. The Bureau may also decide that a particular consumer financial product or service, or the manner in which it is offered, is an unfair, deceptive, or abusive act or practice. If the Bureau so decides, it has the authority to outlaw such act or practice. The FDIC enforces the regulations of the Bureau with regard to Shinhan Bank America.

*Limitations on Dividends.* The payment of dividends by Shinhan Bank America is subject to various regulatory requirements. Under New York State Banking Law, a New York-chartered stock bank may declare and pay dividends out of its net profits, unless there is an impairment of capital, but approval of the Superintendent of Banks is required if the total of all dividends declared in a calendar year would exceed the total of its net profits for that year combined with its retained net profits of the preceding two years, subject to certain adjustments.

*Assessments.* Banking institutions are required to pay assessments to both the FDIC and the Department to fund the operations of those agencies. The assessments are based upon the amount of Shinhan Bank America's total assets. Shinhan Bank America must also pay an examination fee to the Department when it conducts an examination.

*Transactions with Related Parties.* Shinhan Bank America's authority to engage in transactions with related parties or affiliates (i.e., any entity that controls or is under common control with an institution) or to make loans to certain insiders is limited by Sections 23A and 23B of the Federal Reserve Act. Section 23A limits the aggregate amount of transactions with any individual affiliate to 10% of the capital and surplus of the institution and also limits the aggregate amount of transactions with all affiliates to 20% of the institution's capital and surplus. The term affiliate includes, for this purpose, us and any company that we control other than Shinhan Bank America and its subsidiaries.

Loans to affiliates must be secured by collateral with a value that depends on the nature of the collateral. The purchase of low quality assets from affiliates is generally prohibited. Loans and asset purchases with affiliates, must be on terms and under circumstances, including credit standards, that are substantially the same or at least as favorable to the institution as those prevailing at the time for comparable transactions with nonaffiliated companies. In the absence of comparable transactions, such transactions may only occur under terms and circumstances, including credit standards that in good faith would be offered to or would apply to nonaffiliated companies. Shinhan Bank America's authority to extend credit to executive officers, directors and 10% shareholders, as well as entities controlled by such persons, is currently governed by Regulation O of the Federal Reserve Board. Regulation O generally requires such loans to be made on terms substantially similar to those offered to unaffiliated individuals (except for preferential loans made in accordance with broad based employee benefit plans), places limits on the amount of loans Shinhan Bank America may make to such persons based, in part, on Shinhan Bank America's capital position, and requires certain approval procedures to be followed.

*Standards for Safety and Soundness.* FDIC regulations require that Shinhan Bank America adopt procedures and systems designed to foster safe and sound operations in the areas of internal controls, information systems, internal and audit systems, loan documentation, credit underwriting, interest rate risk exposure, asset growth,



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asset quality, earnings and compensation, fees and benefits. Among other things, these regulations prohibit compensation and benefits and arrangements that are excessive or that could lead to a material financial loss. If Shinhan Bank America fails to meet any of these standards, it will be required to submit to the FDIC a plan specifying the steps that will be taken to cure the deficiency. If it fails to submit an acceptable plan or fails to implement the plan, the FDIC will require it to correct the deficiency and until corrected, may impose restrictions on it.

The FDIC has also adopted regulations that require Shinhan Bank America to adopt written loan policies and procedures that are consistent with safe and sound operation, are appropriate for its size, and must be reviewed by its Board of Directors annually. Shinhan Bank America has adopted such policies and procedures, the material provisions of which are discussed above as part of the discussion of our lending operations.

### ***U.S. Regulation of Other U.S. Operations***

In the United States, Shinhan Investment America Inc., our U.S.-registered broker-dealer subsidiary, is subject to regulations that cover all aspects of the securities business, including, sales methods, trade practices among broker-dealers, use and safekeeping of clients' funds and securities, capital structure; record-keeping, the financing of clients' purchases, and the conduct of directors, officers and employees.

Shinhan Investment America Inc. is regulated by a number of different government agencies and self-regulatory organizations, including the SEC and the Financial Industry Regulatory Authority (FINRA). Our U.S. subsidiaries are also regulated by some or all of the NYSE, the Municipal Securities Rulemaking Board, the U.S. Department of the Treasury, the Federal Reserve, and the Commodities Futures Trading Commission. In addition, the U.S. states, provinces and territories have local securities commissions that regulate and monitor activities in the interest of investor protection. These regulators have a variety of sanctions available, including the authority to conduct administrative proceedings that can result in censure, fines, the issuance of cease-and-desist orders or the suspension or expulsion of the broker-dealer or its directors, officers or employees.

FINRA is dedicated to investor protection and market integrity through effective and efficient regulation and complementary compliance and technology-based services. FINRA covers a broad spectrum of securities businesses, including, registering and educating industry participants, examining securities firms, writing rules, enforcing those rules and the federal securities laws, informing and educating the investing public, providing trade reporting and other industry utilities, and administering a dispute resolution forum for investors and registered firms. It also performs market regulation under contract for the NASDAQ Stock Market, the American Stock Exchange and the Chicago Climate Exchange.

Many of the provisions of the Dodd-Frank Act discussed above will affect the operation of Shinhan Investment America, as well as our U.S. banking operations. Again, the impact of this statute on our operations will depend on the final regulations ultimately adopted by various agencies and oversight boards in coming years.

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**ITEM 4.C. Organizational Structure**

As of the date hereof, we have 13 direct and 18 indirect subsidiaries. The following diagram provides an overview of our organizational structure, including our significant subsidiaries and our ownership of such subsidiaries as of the date of this annual report:

All of our subsidiaries are incorporated in Korea, except for the following:

Shinhan Asia Limited (incorporated in Hong Kong);

Shinhan Bank America (incorporated in the United States);

Shinhan Bank Canada (incorporated in Canada);

Shinhan Bank (China) Limited (incorporated in the People's Republic of China);

Shinhan Bank Europe GmbH (incorporated in Germany);

Shinhan Bank Kazakhstan Limited (incorporated in Kazakhstan);

Shinhan Bank Japan (incorporated in Japan);

Shinhan Khmer Bank PLC (incorporated in Cambodia);



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Shinhan Bank Vietnam Ltd. (incorporated in Vietnam);

LLP MFO Shinhan Finance (incorporated in Kazakhstan);

Shinhan Investment Corp., USA Inc. (incorporated in the United States);

Shinhan Investment Corp., Asia Ltd. (incorporated in Hong Kong); and

Shinhan BNP Paribas Asset Management (Hong Kong) Limited (incorporated in Hong Kong).

**ITEM 4.D. Properties**

The following table provides information regarding certain of our properties in Korea.

<b>Type of Facility</b>	<b>Location</b>	<b>Area (In square meters)</b>	
		<b>Building</b>	<b>Site (If Different)</b>
Registered office and corporate headquarters	20, Sejong-daero 9-gil, Jung-gu, Seoul 100-724, Korea	59,519	5,418
Shinhan Investment Corp.	23-2, Youido-dong, Youngdungpo-gu, Seoul, Korea 150-312	70,170	4,765
Shinhan Centennial Building	117, Samgak-dong, Jung-gu, Seoul, Korea	19,697	1,389
Shinhan Bank Gwanggyo Branch	14, 1-ga, Namdaemun-ro, Jung-gu, Seoul, Korea	16,727	6,783
Shinhan Myongdong Branch	53-1, 1-ga, Myong-dong, Jung-gu, Seoul, Korea	8,936	1,014
Shinhan Youngdungpo Branch	57, 4-ga, Youngdungpo-dong, Youngdungpo-gu, Seoul, Korea	6,171	1,983
Shinhan Back Office Support Center	781, Janghang-dong, Ilsan-gu, Goyang-si, Gyeonggi-do, Korea	24,496	5,856
Shinhan Bank Back Office and Call Center	731, Yoksam-dong, Gangnam-gu, Seoul, Korea	23,374	7,964
Shinhan Bank Back Office and Storage Center	1074, Yongam-dong, Sangdang-gu, Cheongju-Si, Chungcheongbuk-do, Korea	6,019	5,376
Shinhan Card Yoksam-Dong Building	790-5, Yoksam-dong, Gangnam-gu, Seoul, Korea	7,348	1,185
Shinhan Data Center	23-2, Jukjeon-dong, Suji-gu, Yongin, Gyeonggi-do, Korea	44,676	9,114
Our subsidiaries own or lease various land and buildings for their branches and sales offices.			

As of December 31, 2014, Shinhan Bank had a countrywide network of 901 branches. Approximately 25.2% of these facilities were housed in buildings owned by us, while the remaining branches were leased properties. As of December 31, 2014, Jeju Bank had 38 branches of which we own 18 of the buildings in which the facilities are located, representing 47.4% of its total branches. Lease terms are generally from two to three years, and seldom exceed five years.

As of December 31, 2014, Shinhan Card had 33 branches, all but one of which was leased. Lease terms are generally from one to two years. We also lease Shinhan Card's headquarters for a term of five years. As of December 31, 2014, Shinhan Investment had a nationwide network of 95 branches of which we own six of the buildings in which the facilities are located, representing 6.3% of its total branches in Korea. Lease terms are generally from one to two years. As of December 31, 2014, Shinhan Life had 186 branches which we leased for a term of generally one to two years.

The net book value of all the properties owned by us at December 31, 2014 was ₩2,742 billion. We do not own any material properties outside of Korea.

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We do not have any unresolved comments from the staff of the U.S. Securities and Exchange Commission regarding our periodic reports under the Securities Exchange Act of 1934, as amended.

**ITEM 5. OPERATING AND FINANCIAL REVIEW AND PROSPECTS**

*You should read the following discussion and analysis of our financial condition and results of operations together with our consolidated financial statements and notes thereto included in this annual report. The following discussion is based on our consolidated financial statements, which have been prepared in accordance with IFRS.*

**ITEM 5.A. Operating Results****Overview**

We are one of the leading financial institutions in Korea in terms of total assets, revenues, profitability and capital adequacy, among others. Incorporated on September 1, 2001, we are the first privately-held financial holding company to be established in Korea. Since inception, we have developed and introduced a wide range of financial products and services in Korea and aimed to deliver comprehensive financial solutions to clients through a convenient one-portal network. According to reports by the Financial Supervisory Service, we are the largest financial services provider in Korea as measured by total assets as of December 31, 2014 and operate the third largest banking business (as measured by consolidated total assets as of December 31, 2014) and the largest credit card business (as measured by the total credit purchase volume as of December 31, 2014) in Korea.

Most of our assets are located in, and we generate most of our income from, Korea. Accordingly, our business and profitability are largely dependent on the general economic and social conditions in Korea, including interest rates, inflation, exports, personal expenditures and consumption, unemployment, demand for business products and services, debt service burden of households and businesses, the general availability of credit, the asset value of real estate and securities and other factors affecting the financial well-being of our corporate and retail customers. The Korean economy is closely integrated with, and is significantly affected by, developments in the global economy and financial markets. In recent years, the global economy and financial markets experienced hardship, which also had a negative impact on the Korean economy and in turn on our business and profitability. See Item 3.D. Risk Factors Risks Relating to our Banking Business Difficult conditions and turbulence in the Korean and global economy and financial markets may adversely affect our business, asset quality, capital adequacy and earnings.

In particular, difficulties in financial and economic conditions could result in significant deterioration in the quality of our assets and accumulation of higher provisioning, allowances for loan losses and charge-offs as an increasing number of our corporate and retail customers declare bankruptcy or insolvency or otherwise face increasing difficulties in meeting their debt obligations. In addition, the continuing slump in the real estate market and the shipbuilding and shipping industries has led to increased delinquency among our corporate borrowers in the construction, real estate leasing, shipbuilding and shipping industries (and in certain cases, even insolvency, corporate restructurings and/or voluntary arrangements with creditors, as was the case for the current and former member companies of the STX Group, Keangnam Enterprises and Dongbu Steel, to each of which we have limited exposure). While we have sought to actively reduce our exposure to such troubled industries through preemptive risk management policies, we cannot assure you that we will not experience further loan losses from borrowers in these industries since the quality of their assets may further deteriorate due to the continued slump in these industries or for other reasons. Shinhan Bank's delinquency ratio (based on one or more month of delinquency) increased from 0.48%

in 2010 to 0.60% in 2011 and 0.61% in 2012, before decreasing to 0.39% in 2013 and decreasing further to 0.31% in 2014 primarily due to Shinhan Bank's active efforts to reduce its exposure to such troubled industries and other at-risk borrowers through preemptive risk management policies and increased lending to borrowers with high-quality credit profiles as part of Shinhan Bank's strategic initiative

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to improve its asset quality. As for Shinhan Card, its delinquency ratio under the Financial Services Commission guidelines increased from 2.01% in 2010 to 2.27% in 2011 and 2.64% in 2012 largely as a result of an increase in its assets, before stabilizing to 2.15% and 2.18% in 2013 and 2014, respectively, largely as a result of its enhanced preemptive risk management and controlled asset growth as well as the sale of large non-performing loans to improve its asset quality.

We derive most of our income from interest earned on our corporate and retail loans, net of funding costs (which primarily consist of interest payable on customer deposits). Net interest income is largely a function of the average volume of loans and the net interest spread thereon.

In 2013, the average volume of retail loans increased by 5.8% from 2012 largely due to an increase in long-term housing rental deposit loans in tandem with a rise in long-term housing rental prices and an increase in retail loans to high quality customers such as police officers and government employees, which more than offset a decrease in new home purchase mortgage loans due to the continued uncertainty in the outlook for the Korean housing market. In 2013, the average volume of corporate loans increased by 2.6%, largely because corporate borrowers increasingly resorted to debenture issuances through capital markets rather than bank borrowings as their primary funding source due to the ample liquidity in the Korean financial sector and low interest rates available for such debentures. In 2014, the average volume of retail loans grew by 6.1% from 2013, largely due to a continued increase in lending to borrowers with high credit profiles and government employees with relatively strong job security (such as police officers and firefighters) as part of our strategic initiative to increase the volume of lending while maintaining or improving the profit margin and asset quality for such lending, an increase in the volume of long-term housing rental deposit loans in tandem with a growing preference for long-term housing rental in lieu of home ownership due in part to the continued uncertainty in the outlook for the Korean real property market, and a substantial increase in the volume of housing mortgage loans in the second half of 2014 following the series of Government plans to stimulate the general economy and the real estate market through various monetary, fiscal and deregulatory measures as announced in the second half of 2014. In 2014, the average volume of corporate loans increased by 4.7% from 2013, largely due to relatively stable growth in loans to small- to medium-sized enterprises (which mainly resulted from heightened marketing focus on the good-quality smaller-sized enterprises that are not required to be audited by outside directors) and loans to large corporations (which mainly resulted from an increase in demand for facility loans and acquisition financing).

From 2012 to 2013, both the average yield on interest-earning assets and the average rate on interest-bearing liabilities decreased (with the former decreasing more than the latter due to the difference in relative maturity profiles) while the average balance increased for both interest-earning assets and interest-bearing liabilities. Largely due to the greater decrease in the average yield on interest-earning assets compared to that for the average rate on interest-bearing liabilities, Shinhan Bank's net interest income decreased by 8.7% from ~~₩~~4,768 billion in 2012 to ~~₩~~4,351 billion in 2013. Net interest income after provision for loan losses amounted to ~~₩~~3,950 billion and ~~₩~~3,677 billion in 2012 and 2013, respectively. Shinhan Bank's operating income also decreased by 17.2% from ~~₩~~2,078 billion in 2012 to ~~₩~~1,720 billion in 2013.

From 2013 to 2014, both the average yield on interest-earning assets and the average rate on interest-bearing liabilities decreased (with the former decreasing more than the latter due to the difference in relative maturity profiles), including as a result of the decreases in the base interest rate set by the Bank of Korea in August and October 2014, while the average balance increased for both interest-earning assets and interest-bearing liabilities. While the base rate decreases in 2014 had the impact of substantially narrowing the interest rate spread, such impact was largely offset by the increase in the average balance of loans as discussed above. As a result, Shinhan Bank's net interest income remained relatively stable from ~~₩~~4,351 billion in 2013 to ~~₩~~4,367 billion in 2014. Net interest income after provision for loan losses increased by 6.1% from ~~₩~~3,677 billion in 2013 to ~~₩~~3,903 billion in 2014 due to a decrease in

provisioning in reflection of the improvement of Shinhan Bank's overall asset quality. Shinhan Bank's operating income increased by 4.5% from ₩1,720 billion in 2013 to ₩1,797 billion in 2014.

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As for Shinhan Card, its operating revenue is largely dependent on the transaction volume and less sensitive to interest rate movements than our banking business, since merchant fees (representing a fixed percentage of a credit card purchase amount) provide a stable source of income and our credit card business enjoys more diversified sources of funding, including commercial paper, corporate debentures (which have maturities longer than most bank deposit products) and asset-backed securitizations. The credit card transaction volume is largely dependent on the overall trends of the general Korean economy, such as general consumer spending patterns in Korea. Shinhan Card's operating revenues remained largely stable from ₩4,599 billion in 2012 to ₩4,615 billion in 2013 and to ₩4,597 billion in 2014, in each case, largely due to increase in merchant fees collected due to an increase in the volume of credit purchases (especially through check cards), as well as an increase in the volume of credit card loans, which were substantially offset by a decrease in the volume of cash advances. The volume of cash advances has been in a steady decline since 2013 after we ceased allowing installment repayments and a revolving facility for cash advances; partly as a result of a substitution effect, credit card loans have increased instead.

The following provides a discussion of the major trends surrounding the general economy and the financial services sector in Korea in 2014 and our current outlook for 2015 as they relate to our core businesses. The following discussion represents the subjective view of our management and may significantly differ from the actual results for 2015.

***Recent Developments and Outlook for Korean Economy***

During 2014, the global economy underwent divergent paths of growth, with the U.S. economy showing signs of stable and robust growth starting in the second half, while the rest of the world, such as China, Japan and Europe, experienced anemic growth or slowdown. Partly as a result of such developments, the U.S. government ended the quantitative easing program while China, Japan and Europe are likely to continue, if not strengthen, expansionary monetary policies. We expect such divergence to continue in 2015. As for the Korean economy in 2014, it suffered a temporary slowdown in the first half due to the Sewol ferry incident which chilled consumer spending, but rebounded to a limited extent on the back of the government's stimulus policies in the second half.

In 2015, we expect that the Korean economy will post limited growth assuming continuation of expansionary monetary policies by the Korean government and growth in exports, particularly into the United States. However, significant uncertainties remain, including in the form of the magnitude and speed of the tightening of the money supply by the U.S. government, potential deflation in the Euro zone, slowdown in Chinese and other emerging market economies and the escalation of geopolitical concerns surrounding the Middle East and Russia, and the ensuing risks for the international financial markets and the global economy, any of which may have a material adverse effect on the Korean economy.

As for interest rate movements, in 2014 market interest rates generally declined in Korea due to sluggish domestic demand, low inflation level and inflow of foreign capital. In 2015, there was a further base interest rate decrease by the Bank of Korea to a historic low of 1.75%. In light of such development and also the projected modest growth of Korean economy in 2015, we expect that the low interest rate environment will generally continue in 2015, assuming all other things equal, including no sudden and substantial monetary tightening by governments in the United States and other major economies for policy or other reasons.

***Recent Developments and Outlook for the Korean Financial Sector******Commercial Banking***

In 2014, major commercial banks in Korea generally experienced modest growth in terms of assets and revenues, principally due to a rebound in demand for loans from retail and corporate customers. The asset quality also improved to a limited extent in terms of both delinquency and non-performing loan ratio. However, net interest margin generally tightened for the commercial banks largely due to a decrease in the base rates set by the Korean government as well as intensifying competition among Korean banks, particularly in relation to certain qualified fixed rate and installment payment loans.



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In 2015, we expect Korean commercial banks to post modest loan growth in tandem with the expected growth in the overall Korean economy. We also expect the asset quality for Korean commercial banks to remain largely stable in 2015 in light of preemptive debt restructuring and conservative provisioning over the recent years. However, in the case of a sharp or sustained rise in interest rates including as a result of a monetary tightening by the U.S. government as currently expected, credit risk may significantly increase in light of the high level of household debt in Korea.

We are currently not aware of any major regulatory developments that may adversely affect the commercial banking industry in Korea. However, the prolonged low-interest rate environment has limited opportunities for commercial banks to generate profit by taking advantage of the differences between deposits and loans, and has fueled intense competition among major commercial banks for quality customers. Furthermore, as online service providers with large-scale user networks, such as Daum Kakao, make significant inroads in providing virtual payment services through a system based on a growing convergence of financial services and technology commonly referred to as *fintech*, competition for online customers is growing not just among commercial banks, but also from online service providers. Accordingly, the commercial banks are facing increasing pressure to upgrade their service platforms to attract and maintain online users, which represents a growing customer base compared to traditional customers who have primarily conducted banking in-person at physical banking branches.

### *Credit Cards*

In 2014, credit companies in Korea generally experienced steady growth in profitability and stable asset quality, largely due to steadfast retail spending, cost-cutting measures undertaken by the credit card companies and stabilization in the delinquency ratio, notwithstanding the chilling effect of the Sewol ferry accident on consumer sentiment and the suspension of operation for certain card companies following accidental leaks of customer data.

In 2015, we expect that the credit card companies will continue to record stable revenue and asset growth in tandem with the growth in the overall Korean economy following fiscal and monetary stimulus by the Korean government. However, the expected rise in the cost of funding following the anticipated increase in base interest rates and the risk of aggressive marketing, particularly among credit card companies in the mid- to lower-tiers, may undercut the profitability of the credit card companies. In addition, given the already high level of household debt, an increase in interest rates may adversely impact the borrower's ability to repay and hence lead to an increase in delinquency.

On the regulatory side, the Korean financial regulators continue to introduce measures designed to enhance protection of financial service consumers, and particularly so in the aftermath of the accidental leaks of customer data by certain credit card companies in 2014. As for the competition, competition is expected to remain intense given that the Korean credit card market is mature and saturated and as the mobile payment systems being introduced by online service providers become more prevalent.

### *Securities*

In 2014, securities companies in Korea experienced a slight turnaround after years of difficulties related to decreases in trading volume and brokerage fee rates, largely due to a rise in the KOSPI index in the second half and an increase in sales of equity/debt-linked products in part as a result of the sustained low-interest rate environment in Korea. However, the Korean securities brokerage industry remains overcrowded, and competition remains intense, particularly in the traditional securities brokerage services, although there recently has been an increase in consumer appetite for structured investment products, such as equity/debt-linked products.

In 2015, we expect the securities companies on average to experience improvements in profitability largely as a result of growth in the overall Korean economy and cost-savings from redundancy elimination in the workforce, but only to

a limited extent in light of the expected loss in valuation and decrease in sales of fixed

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income securities in the case of a rise in the base interest rates. In addition, we expect that securities companies that can offer competitive new products, particularly in the area of investment products with a mid-range risk/return profile, will reap the majority of the benefits.

On the regulatory side, the Korean financial regulators are considering measures to curb self-regulation in margin lending, while liberalizing the procedures and processes for licensing and other government approvals, incentivizing initial public offerings for promising ventures and creating opportunities for scalable investment banking through integration of investment services. On the competitive side, we expect competition to remain intense as the securities brokerage industry is already overcrowded with relatively low barriers of entry, although the industry is showing some signs of consolidation (such as the sale of Woori Investment & Securities to NH Securities, the proposed sale of several small- to medium-sized securities brokerage firms and the acquisition of TongYang Securities by Yuanta Securities of Taiwan), which may improve, even if slightly, the competitive landscape for Korean securities brokerage firms in the future.

### *Life Insurance*

In 2014, life insurance companies in Korea generally showed signs of normalization concerning revenues, driven largely by rising demand for endowment health insurance products. However, the low interest rate environment continued to hurt the profitability of these companies, particularly with respect to certain annuities and saving products which yielded negative net interest margin, despite cost saving efforts by the insurance companies, including redundancy elimination in workforce and branch network.

In 2015, we expect life insurance companies to experience improvements in revenues and profitability in tandem with growth in the overall Korean economy. However, the direction and magnitude of interest rate movements will remain critical and the insurance companies will increasingly be forced to look for additional opportunities for income, such as through endowment insurance, innovative products for the elderly and privately funded insurance, and enhance risk management and funding management policies given the likelihood of a sustained low-interest rate environment.

We are currently not aware of any major regulatory developments that may adversely affect the life insurance industry in Korea. On the competitive side, competition is expected to remain intense as the life insurance industry in Korea is mature and saturated, and the ability to offer differentiated services in order to attract the growing population of the elderly and the retirees' products will continue to be an ever important competitive factor.

### *Asset Management*

In 2014, the asset management companies generally experienced growth in the size of assets under management largely due to increased demand for their services from corporate customers, despite an increase in redemption by retail customers. However, given that the asset management services for corporate customers generally yield low rates of fees, the growth in profitability was limited.

In 2015, we expect that asset management companies will face greater divergence in terms of profitability as the markets are likely to experience greater turbulence in the face of a sustained low interest rate environment, which typically heightens customers' sensitivity to the rates of return and hence their loyalty to a particular asset management service provider.

The asset management service industry is highly volatile and sensitive to the general trends in the overall cycles in the general economy and financial markets. Competition for this industry is likely to remain intense given the relatively low barriers of entry and the difficulty to differentiate services. On the regulatory side, the Korean government has

recently announced that it may liberalize the rules of pension fund management. Such development may create business opportunities for asset management service providers, particularly in the area of dividend-paying pension management products.

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In 2015, we anticipate the following areas to be important for the growth and profitability of asset management companies: stronger disclosure policies and practices in response to the anticipated adoption by the Government of stricter measures for financial consumer protection, enhanced asset management capabilities in the face of expected volatilities in interest rates and equity market indices and product differentiation strategies (particularly for structured investment products) to meet growing customer demand for diversified investment portfolios and stable returns on investments.

***Specialized Credit***

The specialized credit business was introduced in Korea in August 1997. The specialized credit business cannot accept customer deposits and generally involves providing a combination of four types of financing: equipment and facilities leasing, installment finance, new technology finance and credit card services, and sources funding primarily by issuing debentures and commercial papers. The specialized credit business generally targets customers with higher risk profile in return for higher return compared to customers of commercial banks, which makes risk management (including customer screening) a particularly key factor for commercial success of this business.

Due, in part, to the variety of services being offered and the broad range of potential customers, specialized credit providers often find it relatively easy to develop new customer segments and provide niche offerings. Due to the relatively low barriers of entry, however, competition is intense and is expected to further intensify as a result of the commencement of automobile loan offerings by commercial banks and the expanded entry into personal loan markets by micro lenders.

The financial supervisory authorities have submitted a proposal to the legislature which would consolidate three types of specialized credit services, namely, equipment and facilities leasing, installment finance and new technology finance, in order to bolster the capacity of specialized credit providers to support corporate finance. We expect that specialized credit providers will continue to focus their efforts on finding new business opportunities, including by expanding the new technology finance segment and selective overseas expansions.

***Interest Rates***

Interest rate movements, in terms of magnitude and timing as well as their relative impacts on our assets and liabilities, have a significant impact on our net interest margins and profitability, particularly with respect to its financial products that are sensitive to such movements. For example, if the interest rates applicable to Shinhan Bank's loans (which are recorded as our assets) decrease at a faster pace or by a thicker margin, or increase at a slower pace or by a thinner margin, compared to the interest rates applicable to its deposits (which are recorded as our liabilities), Shinhan Bank's net interest margin will shrink and its profitability will be negatively affected. In addition, the relative size and composition of Shinhan Bank's variable rate loans and deposits (as compared to our fixed rate loan and deposits) may also impact Shinhan Bank's net interest margin. Furthermore, the difference in the average term of Shinhan Bank's interest-earning assets (primarily loans) compared to its interest-bearing liabilities (primarily deposits) may also impact its net interest margin. For example, since Shinhan Bank's deposits currently have a longer term, on average, than that of its loans, its deposits are on average less sensitive to movements in the base interest rates on which its deposits and loans tend to be pegged, and therefore, an increase in the base interest rates tends to increase its net interest margin while a decrease in the base interest rates tends to have the opposite effect. Since Shinhan Bank is one of our principal operating subsidiaries, its net interest margin and profitability have a substantial effect on ours. While we continually manage our assets and liabilities to minimize our exposure to the interest rate volatility, such efforts by us may not mitigate the impact of interest rate volatility in a timely or effective manner.

The interest rate charged to customers by our banking subsidiaries is based, in part, on the cost of funding index, or COFIX, which is published by the Korean Federation of Banks. COFIX is computed based on the weighted average interest of select funding products (including time deposits, housing and other installment savings deposits, repos, discounted bills and senior non-convertible financial debentures) of nine major Korean

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banks (comprised of Kookmin Bank, Shinhan Bank, Woori Bank, Hana Bank, Korea Exchange Bank, Nonghyup Bank, Industrial Bank of Korea, Citibank Korea and Standard Chartered Bank Korea). Each bank then independently determines the interest rate applicable to its respective customers by adding a spread to the COFIX based on the difference between the COFIX and such bank's general funding costs, administration fees, the customer's credit score, the maturity of the loan and other customer-specific premiums and discounts based on the customer relationship with such bank. These interest rates are typically adjusted on a monthly basis.

The following table shows certain benchmark Won-denominated borrowing interest rates as of the dates indicated.

	<b>Corporate Bond Rates<sup>(1)</sup></b>	<b>Treasury Bond Rates<sup>(2)</sup></b>	<b>Certificate of Deposit Rates<sup>(3)</sup></b>	<b>COFIX Balance-Based<sup>(4)</sup></b>	<b>COFIX New Borrowing-Based<sup>(5)</sup></b>
June 30, 2010	4.77	3.86	2.46	3.95	2.89
December 31, 2010	4.27	3.38	2.80	3.72	3.10
June 30, 2011	4.49	3.76	3.57	3.88	3.66
December 31, 2011	4.21	3.34	3.55	3.95	3.69
June 30, 2012	3.87	3.30	3.54	3.91	3.63
December 31, 2012	3.29	2.82	2.89	3.57	3.01
June 30, 2013	3.31	2.88	2.69	3.17	2.66
December 31, 2013	3.29	2.86	2.66	2.91	2.60
June 30, 2014	3.10	2.68	2.65	2.79	2.59
December 31, 2014	2.43	2.10	2.13	2.58	2.10

Source: Korea Securities Dealers Association

Notes:

- (1) Measured by the yield on three-year AA- rated corporate bonds.
- (2) Measured by the yield on three-year treasury bonds.
- (3) Measured by the yield on certificates of deposit (with maturity of 91 days).
- (4) Measured based on the weighted average of the borrowing rates for the monthly ending balances of the funding made by the commercial banks that are subject of the COFIX reporting.
- (5) Measured based on the weighted average of the borrowing rates for new funding for each month made by the commercial banks that are subject of the COFIX reporting.

**Changes in Accounting Policies**

*Classification of hybrid financial instruments by the holder*

Prior to 2014, we had previously classified our investments in hybrid financial instruments as investments in equity securities from the holder's perspective. In 2014, we determined that the host contract of a hybrid financial instrument can be classified as either equity or debt instruments based on the interpretation letter issued by the Korea Accounting Institute. Accordingly, we reclassified hybrid bonds, of which total face value is ₩130 billion as of December 31, 2014, held for investment purposes by Shinhan Life Insurance from equity securities to debt securities because the purpose of investment by Shinhan Life Insurance was to invest in debt securities for asset-liability management purpose. We have applied the changes in accounting policy retrospectively and restated the comparative prior year financial statements and the relevant disclosures in notes to the consolidated financial statements. See note 48 to the financial statements included in this annual report for the effect of the change in accounting policy.

**Critical Accounting Policies**

The accounting policies set out below have been applied consistently to all periods presented in these consolidated annual financial statements, unless otherwise indicated.



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We and our subsidiaries have consistently applied these accounting policies.

### ***Basis of Consolidation***

#### ***Subsidiaries***

Subsidiaries are entities that we control. The financial statements of our subsidiaries are included in the consolidated financial statements from the date that control commences until the date that control ceases. The accounting policies of our subsidiaries have been changed when necessary to align them with the policies we have adopted.

#### ***Structured Entities***

We have established or invested in various structure entities. A structured entity is an entity designed so that its activities are not governed by way of voting rights. When assessing control of a structured entity, we consider factors such as the purpose and the design of the investee; our practical ability to direct the relevant activities of the investee; the nature of our relationship with the investee; and the size of our exposure to the variability of returns of the investee. We do not recognize any non-controlling interests in the consolidated statements of financial position since our interests in these entities are recognized as liabilities of us.

#### ***Investments in Associates and Joint Arrangements (Collectively, Associates )***

Associates are those entities in which we have significant influence, but not control, over the financial and operating policies. Significant influence is presumed to exist when we hold between 20% and 50% of the voting power of another entity or in excess of 15% if the other entity is classified as a subsidiary under the Banking Act. A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require the unanimous consent of the parties sharing control.

Investments in associates are accounted for using the equity method and are recognized initially at cost. Our investment includes goodwill identified on acquisition, net of any accumulated impairment losses. The consolidated financial statements include our share of the income and expenses and equity movements of associates, after adjustments to align their accounting policies with ours, from the date that significant influence or joint control commences until the date that significant influence or joint control ceases. When our share of losses exceeds our interest in an equity accounted investee, the carrying amount of that interest, including any long-term investments, is reduced to nil, and the recognition of further losses is discontinued except to the extent that we have an obligation or are otherwise required to make payments on behalf of the investee.

#### ***Transactions Eliminated on Consolidation***

Intra-group balances, transactions, and any unrealized income and expenses arising from intra-group transactions, are eliminated in preparing the consolidated financial statements. Unrealized gains arising from transactions with associates are eliminated against the investment to the extent of our interest in the investee. Unrealized losses are eliminated in the same way as unrealized gains, but only to the extent that there is no evidence of impairment.

### ***Foreign Currency***

#### ***Foreign Currency Transactions***

Transactions in foreign currencies are translated to the respective functional currencies of us and our subsidiaries at exchange rates at the dates of the transactions. Monetary assets and liabilities denominated in foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date.

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The foreign currency gain or loss on monetary items is the difference between amortized cost in the functional currency at the beginning of the period, adjusted for effective interest and payments during the period, and the amortized cost in foreign currency translated at the exchange rate at the end of the reporting period. Non-monetary assets and liabilities denominated in foreign currencies that are measured at fair value are translated to the functional currency at the exchange rate at the date that the fair value was determined. Foreign currency differences arising on translation are recognized in profit or loss, except for differences arising on the translation of available-for-sale equity instruments, a financial liability designated as a hedge of the net investment in a foreign operation or in a qualifying cash flow hedge, which are recognized in other comprehensive income. Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rate at the date of the transaction.

### *Foreign Operations*

The assets and liabilities of foreign operations, including goodwill and fair value adjustments arising on acquisition, are translated into Won at exchange rates at the reporting date. The income and expenses of foreign operations, excluding foreign operations in hyperinflationary economies, are translated into Won at exchange rates at the dates of the transactions.

Foreign currency differences are recognized in other comprehensive income in the translation reserve.

When a foreign operation is disposed of, the relevant amount in the translation is transferred to profit or loss as part of the profit or loss on disposal. In any other partial disposal of a foreign operation, the relevant proportion is reclassified to profit or loss.

### *Cash and Cash Equivalents*

Cash and cash equivalents comprise cash balances and call deposits with maturities of three months or less from the acquisition date that are subject to an insignificant risk of changes in their fair value, and are used by us in the management of our short-term commitments.

### *Non-derivative Financial Assets*

Financial assets are classified into financial assets at fair value through profit or loss, loans and receivables, available-for-sale financial assets and held-to-maturity financial assets. Financial assets are recognized in the consolidated financial statements when we become a party to the contractual provisions of the instrument.

A financial asset is measured initially at its fair value plus, for an item not at fair value through profit or loss, transaction costs that are directly attributable to its acquisition of the financial asset.

### *Financial Assets at Fair Value through Profit or Loss*

A financial asset is classified as held for trading or designated at fair value through profit or loss upon initial recognition. These financial assets are measured at fair value after initial recognition and changes in the fair value are recognized through profit or loss of the period. Costs attributable to the acquisition are immediately expensed in the period.

### *Held-to-maturity Financial Assets*

Held-to-maturity financial assets are non-derivative assets with fixed or determinable payments and fixed maturity that we have the positive intent and ability to hold to maturity. They are carried at amortized cost using the effective interest method after their initial recognition.

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**Table of Contents***Loans and Receivables*

Loans and receivables are financial assets with fixed or determinable payments that are not quoted in an active market. Such assets are recognized initially at fair value plus any directly attributable transaction costs. Subsequent to initial recognition loans and receivables are measured at amortized cost using the effective interest method, less any impairment losses.

For non-collateral dependent loans, impairment is measured using a discount cash flow analysis under which allowances are established when the discounted cash flow of the loan is lower than its carrying amount. The allowance is equal to the difference between the discounted cash flow amount of the loan and its carrying amount. With respect to collateral dependent loans, our discount cash flow analysis considers, among other things, the fair value of the collateral underlying the subject loan. When the carrying amount of the subject loan is higher than the fair value of the collateral, the carrying amount is written down to the fair value of the collateral. The fair value of the collateral is determined as the present value of the estimated realizable value of the collateral at the expected time of the sale of such collateral. Once the valuation report of the court-appointed appraiser becomes publicly available as part of a foreclosure proceeding, we use the appraisal value for the collateral indicated in such report as the estimated realizable value of the collateral. However, until such publication, we use the valuation amount for the collateral as determined by outside independent appraisers at the time that the subject loan was initially approved, with adjustments made for the change in value from the effect of time passage and current market circumstances that may impact the value of the collateral.

As a general rule, we obtain updated appraisal on an annual basis for all collateral dependent loans and therefore, adjust the appraisal value of loans every 12 months. We estimate the fair value of collateral with outdated appraisal value primarily on the basis of the publicly available standard reference prices as officially published by the government (or (x) in the case of collateral in the form of apartment units, the real estate market price database maintained by Kookmin Bank for apartment units, (y) in the case of collateral in the form of other communal housing units, the publicly available standard reference prices as officially published by the Ministry of Land, Infrastructure and Transport or (z) in the case of commercial buildings, the publicly available standard reference prices as officially published by the National Tax Service), except that (i) if there are bid prices for such collateral, we use as the fair value the lowest bid price deemed to be credible as to the bidder's intent to purchase based on the written bid submitted by such purchaser and (ii) in the circumstances where we deem that the aforesaid reference prices do not accurately reflect the true value of such land, for example, due to a downturn in the relevant real estate market, we hire an outside appraiser to obtain an independent valuation, which valuation is typically derived from 90% or lower of the lowest of two or more sale prices from recent sales of similar types of collateral in the vicinity, and we use such valuation as the fair value for such collateral. Other than in the case of a bid price which is higher than the original appraisal value, we design our fair value estimation system so that the adjusted fair value does not exceed the original appraisal value and hence, in the absence of a higher bid price, the adjustments made have the effect of assigning a fair value lower than the original appraisal value. Since the magnitude of adjustments is principally dependent on reference prices maintained by the Government or bid prices, which are in turn dependent on the market prices, it varies case by case and is therefore difficult to compute the average adjustments made to outdated appraisals. After making such adjustments, we also internally appraise each collateral at least annually in order to ensure that the adjusted value is fair and reasonable.

We implement the following procedures to minimize the potential for outdated appraisal values being reflected in allowance for loan losses: (i) the date of appraisal is assigned next to the appraisal value to facilitate identification of an appraisal value as being outdated, (ii) our internal audit department constantly monitors the status of appraisal values, and (iii) the loan-to-value ratio, usually 60%, is strictly enforced when making the original loan so that the value of collateral typically stays above the outstanding loan amount during the life of the loan even in the case of an

adjustment to the original appraisal value. If in the limited circumstances where the adjusted fair value of collateral falls below the outstanding loan amount, if the loan is impaired, we promptly set aside allowance for loan losses for such difference in amount.

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### *Available-for-sale Financial Assets*

Available-for-sale financial assets are the non-derivative financial assets that are designated as available-for-sale or are not classified as financial assets at fair value through profit or loss, held-to-maturity investments or loans and receivables. They are measured at fair value after their initial recognition.

### *Derecognition of Financial Assets*

We derecognize a financial asset when the contractual rights to the cash flows from the asset expire, or we transfer the rights to receive the contractual cash flows on the financial asset in a transaction in which substantially all the risks and rewards of ownership of the financial asset are transferred. Any interest in transferred financial assets that we create or retain is recognized as a separate asset or liability.

### *Offsetting*

Financial assets and liabilities are offset and the net amount presented in the consolidated statements of financial position when, and only when, we have a legal right to offset the amounts and intend either to settle on a net basis or to realize the asset and settle the liability simultaneously.

### *Impairment of Financial Assets*

We assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets except for financial assets at fair value through profit or loss is impaired. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset and that loss event has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. Objective evidence that financial assets are impaired includes significant financial difficulty of the borrower or issuer, default or delinquency in interest or principal payments, restructuring of a loan or a concession granted by us, which we would not otherwise consider, indications that a borrower or issuer will enter bankruptcy or other financial reorganization, or observable data such as an increased number of delayed payments indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets.

### *Loans and Receivables*

We first assess whether objective evidence of impairment exists individually for loans and receivables that are individually significant, and individually or collectively for financial assets that are not individually significant. If we determine that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, we include the asset in a group of financial assets with similar credit risk characteristics and collectively assess them for impairment. Assets that are individually assessed for impairment and for which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

If there is objective evidence that an impairment loss on loans and receivables has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition).

If the interest rate of loans and receivables is a floating rate, the discount rate used to evaluate impairment loss is the current effective interest rate defined in an agreement. The present value of estimated future cash flows of secured financial assets is calculated by including cash flows from collateral after deducting costs to acquire and sell the collateral, regardless of the probability of realization of such collateral.



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In assessing collective impairment, we rate and classify financial assets, based on a credit risk assessment or credit rating assessment process that takes into account asset type, industry, regional location, collateral type, delinquency and other relative factors.

Future cash flow of financial assets applicable to collective impairment assessment is estimated by using statistical modeling of historical trends of the probability of default, timing of recoveries and the amount of loss incurred, adjusted for management's judgment as to whether current economic and credit conditions are such that the impairment losses are likely to be greater or less than suggested by historical modelling. In adjusting the future cash flow by historical modelling, the result has to be in line with changes and trends of observable data (e.g., impairment loss of collective assets and unemployment rate, asset price, commodity price, payment status and other variables representing the size of implement loss). Methodologies and assumptions used to estimate future cash flow are reviewed on a regular basis in order to narrow down discrepancy between impairment loss estimation and actual loss.

Impairment losses are recognized in profit or loss and reflected in an allowance account against loans and receivables. When a subsequent event causes the amount of impairment loss to decrease, and the decrease can be related objectively to an event occurring after the impairment was recognized, the decrease in impairment loss is reversed through profit or loss of the period.

*Allowance for Loan Losses*

Our methodology for determining allowance for loan losses has changed in 2011.

Under both the previous and current methodology, determining allowance for loan losses involves determination both at the individual level and on the aggregate basis. While there is no material difference between our previous and current methodology in determining allowance for loan losses at the individual level except for differences in its recognition of loan losses as a result of subsequent events, there are certain differences when determining the allowance on the aggregate basis.

When determining allowance for loan losses, under the previous methodology, Shinhan Bank, which accounts for the substantial majority of loans held by Shinhan Financial Group, used a migration model, while under the current methodology, Shinhan Bank used a probability of default / loss-given default ( PD/LGD ) model. Certain differences may arise in allowances for loan losses calculated under the previous migration model and the current PD/LGD model.

Under the previous migration model, when determining allowance for loan losses, Shinhan Bank, which accounts for the substantial majority of loans held by Shinhan Financial Group, applied a migration model based on loan classifications. Shinhan Bank identified the probability of default for corporate loans through a migration model, which uses a statistical tool to monitor the progression of loans through nine different classifications over recent one year, while retail loans uses five different classifications over recent one year and are segmented into the two product types for the purposes of credit risk evaluation, namely, mortgage and home equity loans, and other retail loans (consisting of unsecured and secured retail loans). Loss given default for corporate loans is derived by the loss rate of individually evaluated impaired loans, while retail loans is derived by the historical charge-off and recovery information of the portfolio.

Under the current PD/LGD model, Shinhan Bank calculates the aggregate allowance for loan losses by multiplying (x) the probability of default for each class of borrowers that have been assigned the same credit rating by (y) the loss given default for such class of borrowers. A particular credit rating is assigned individually to each borrower based on (i) the borrower type (namely, household, corporate, SOHOs or high-risk borrowers) and (ii) its particular risk and

credit profile within such type, using our proprietary credit evaluation model.

Our current PD/LGD model determines the probability of default for each class of borrowers having the same credit rating as follows. First, we determine the projected probability of default for such class of borrowers

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using the longer look-back periods under IFRS. However, at least annually (and more frequently during times of heightened systemic risks), we test such projected probability of default against the actual rate of default among such class of borrowers in the 12-months period immediately preceding such testing date. If based on such test the actual rate of default exceeds the mean or the maximum value of projected probability of default, we reassess, on an individual basis and using more conservative metrics, the credit rating assigned to each borrower within such class. Such credit rating reassessment generally has the effect of lowering the credit rating for a substantial number of borrowers that initially belonged to such class, which in turn has the effect of increasing the allowance of losses on an aggregate basis since the pool of borrowers having high credit ratings will have shrunk (and the pool of borrowers having lower credit ratings will have expanded) as the result of the individualized credit rating reassessment. Hence, such recalibration has the effect of reflecting the effects of current conditions in our final determination of the probability of default.

The migration and PD/LGD methods described above also have other differences. Under the previous migration method, the historical loss rate on migration analysis is calculated from a transition matrix table based on asset quality classification and takes into consideration historical loss rates and recovery rates after charge-off, whereas the current PD/LGD method (sophisticated approach), also known as Advanced Internal Rating-Based approach under Basel II, is calculated via measurable long-term risk factors such as probability of default from risk grading and loss given default based on the Basel II framework.

We believe that our current PD/LGD model has the following advantages compared to the previous migration model:

*Statistically more robust while reflecting effects of current condition.* From a statistical perspective, we believe our current PD/LGD model enables a more robust and reliable analysis by adopting a longer look-back period based on the Continuous Time Markov Chain Rating Transition Approach than the one-year migration model does. While adopting a longer look-back period may have the effect of undervaluing the effects of current conditions, our model largely compensates for such potential undervaluation through the annual calibration process discussed above.

*Analytically more fine-tuned.* Our previous migration model analyzed the probability of default based on the following criteria only: retail vs. corporate and secured vs. unsecured. Under our current PD/LGD model, we examine the probability of default based on more granular classification as follows: households, corporate, small-office/home-office (SOHOs) and special high-risk borrowers. In addition, our current PD/LGD model also analyzes loss given default in greater detail, including location, types of collateral, loan-to-value ratios and (in the case of unsecured loans) types of loans.

*More versatile use and improved reliability through greater internal scrutiny.* The previous migration model was used only for the purpose of determining the probability of default in connection of computing allowance for losses based on asset classification. In comparison, our current PD/LGD model is being used for substantially all areas of our credit risk evaluation, including credit ratings, loan review and computation of capital adequacy. Given the more versatile use of our current PD/LGD model and the greater impact on system-wide risk arising from its misuse, we devote greater resources to ensuring the accuracy of this model through heightened scrutiny over its design, implementation and evaluation.

*Available-for-sale Financial Assets*

Impairment losses on available-for-sale financial assets are recognized by transferring the cumulative loss that has been recognized in other comprehensive income, and presented in the fair value reserve in equity, to profit or loss. The cumulative loss that is removed from other comprehensive income and recognized in profit or loss is the difference between the acquisition cost, net of any principal repayment and amortization, and the current fair value, less any impairment loss previously recognized in profit or loss. Changes in impairment provisions attributable to time value are reflected as a component of interest income.

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If, in a subsequent period, the fair value of an impaired available-for-sale debt security increases and the increase can be related objectively to an event occurring after the impairment loss was recognized in profit or loss, then the impairment loss is reversed, with the amount of the reversal recognized in profit or loss. However, any subsequent recovery in the fair value of an impaired available-for-sale equity security is recognized in other comprehensive income.

*Held-to-maturity Financial Assets*

An impairment loss in respect of held-to-maturity financial assets measured at amortized cost is calculated as the difference between its carrying amount and the present value of the estimated future cash flows discounted at the asset's original effective interest rate and is recognized in profit or loss. Interest on the impaired asset continues to be recognized through the unwinding of the discount. When a subsequent event causes the amount of impairment loss to decrease, the decrease in impairment loss is reversed through profit or loss.

*Derivative Financial Instruments*

Derivatives are recognized initially at fair value and attributable transaction costs are recognized in profit or loss as incurred. Subsequent to initial recognition, derivatives are measured at fair value, and changes therein are accounted for as described below.

*Hedge Accounting*

We hold derivative financial instruments to hedge our foreign currency and interest rate risk exposures. On initial designation of the hedge, we formally document the relationship between the hedging instrument(s) and hedged item(s), including the risk management objectives and strategy in undertaking the hedge transaction, together with the methods that will be used to assess the effectiveness of the hedging relationship. We make an assessment, both at the inception of the hedge relationship as well as on an ongoing basis, whether the hedging instruments are expected to be highly effective in offsetting the changes in the fair value or cash flows of the respective hedged items during the period for which the hedge is designated, and whether the actual results of each hedge are within a range of 80-125%. For a cash flow hedge of a forecast transaction, the transaction should be highly probable to occur and should present an exposure to variations in cash flows that could ultimately affect reported net income.

*Fair Value Hedges*

When a derivative is designated as the hedging instrument in a hedge of the change in fair value of a recognized asset or liability or a firm commitment that could affect profit or loss, changes in the fair value of the derivative are recognized immediately in profit or loss together with changes in the fair value of the hedged item that are attributable to the hedged risk (in the same line item in the consolidated statements of comprehensive income as the hedged item).

If the hedging derivative expires or is sold, terminated, or exercised, or the hedge no longer meets the criteria for fair value hedge accounting, or the hedge designation is revoked, hedge accounting is discontinued prospectively. Any adjustment to a hedged item up to the point for which the effective interest method is used is amortized to profit or loss as part of the recalculated effective interest rate of the item over its remaining life.

*Cash Flow Hedges*

When a derivative is designated as the hedging instrument in a hedge of the variability in cash flows attributable to a particular risk associated with a recognized asset or liability or a highly probable forecast transaction that could affect

profit or loss, the effective portion of changes in the fair value of the derivative is recognized in other comprehensive income and presented in the hedging reserve in equity. The amount

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recognized in other comprehensive income is removed and included in profit or loss in the same period as the hedged cash flows affect profit or loss under the same line item in the consolidated statements of comprehensive income as the hedged item. Any ineffective portion of changes in the fair value of the derivative is recognized immediately in profit or loss.

If the hedging instrument no longer meets the criteria for hedge accounting, expires or is sold, terminated, exercised, or the designation is revoked, then hedge accounting is discontinued prospectively. The cumulative gain or loss previously recognized in other comprehensive income and presented in the hedging reserve in equity remains there until the forecast transaction affects profit or loss. If the forecast transaction is no longer expected to occur, then the balance in other comprehensive income is recognized immediately in profit or loss. In other cases the amount recognized in other comprehensive income is transferred to profit or loss in the same period that the hedged item affects profit or loss.

***Net Investment in a Foreign Operation***

If the settlement of a monetary item receivable from or payable to a foreign operation is neither planned nor likely to occur in the foreseeable future, then foreign currency difference arising on the item which in substance is considered to form part of the net investment in the foreign operation, are recognized in the other comprehensive income and shall be reclassified to profit or loss on disposal of the investment.

***Separable Embedded Derivatives***

Embedded derivatives are separated from the host contract and accounted for separately if the economic characteristics and risks of the host contract and the embedded derivative are not closely related, a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative, and the combined instrument is not measured at fair value through profit or loss. Changes in the fair value of separable embedded derivatives are recognized immediately in profit or loss.

***Other Non-trading Derivatives***

When a derivative financial instrument is not held for trading, and is not designated in a qualifying hedge relationship, all changes in its fair value are recognized immediately in profit or loss.

***Property and Equipment***

Items of property and equipment are measured at cost less accumulated depreciation and accumulated impairment losses. We elect to measure land and buildings at fair value at the date of transition and use those fair values as their deemed costs.

The cost of replacing a part of an item of property or equipment is recognized in the carrying amount of the item if it is probable that the future economic benefits embodied within the part will flow to us and its cost can be measured reliably. The carrying amount of the replaced cost is derecognized. The cost of the day to day servicing of property and equipment are recognized in profit or loss as incurred.

Land is not depreciated. Other property and equipment are depreciated on a straight-line basis over their estimated useful life, which most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. Leased assets under finance lease are depreciated over the shorter of the lease term and their useful lives. The estimated useful lives for the current and comparative periods are as follows:

<b>Descriptions</b>	<b>Depreciation Method</b>	<b>Useful Lives</b>
Buildings	Straight-line	40 years
Other properties	Straight-line	4~5 years



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Depreciation methods, useful lives and residual value are reassessed at each fiscal year-end and any adjustment is accounted for as a change in accounting estimate.

### ***Intangible Assets***

#### ***Goodwill***

Goodwill that arises upon the acquisition of subsidiaries is included in intangible assets. Goodwill is measured at cost less accumulated impairment losses. In respect of associates, the carrying amount of goodwill is included in the carrying amount of the investment, and an impairment loss on such an investment is not allocated to any asset, including goodwill, that forms part of the carrying amount of the equity method accounted investee.

#### ***Research and Development***

Expenditure on research activities, undertaken with the prospect of gaining new scientific or technical knowledge and understanding, is recognized in profit or loss as incurred.

Development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalized only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and we intend to and have sufficient resources to complete development and to use or sell the asset. The expenditure capitalized includes the cost of materials, direct labor, overhead costs that are directly attributable to preparing the asset for its intended use, and borrowing costs on qualifying assets for which the commencement date for capitalization is on or after January 1, 2010. Other development expenditure is recognized in profit or loss as incurred.

Capitalized development expenditure is measured at cost less accumulated amortization and accumulated impairment losses.

#### ***Intangible Assets such as Club Memberships with Indefinite Useful Lives***

There are no foreseeable limits to the periods over which club memberships are expected to be available for use. This intangible asset is determined as having indefinite useful lives and not amortized.

The useful lives of intangible assets that are not being amortized are reviewed at the end of each reporting period to determine whether events and circumstances continue to support indefinite useful life assessments for those assets. Changes are accounted for as changes in accounting estimates.

#### ***Other Intangible Assets***

Other intangible assets with finite useful lives that we acquire are measured at cost less accumulated amortization and accumulated impairment losses.

#### ***Amortization***

Amortization is calculated over the cost of the asset, or other amount substituted for cost, less its residual value. Amortization is recognized in profit or loss on a straight-line basis over the estimated useful lives of intangible assets, other than goodwill, from the date that they are available for use, since this most closely reflects the expected pattern of consumption of the future economic benefits embodied in the asset. The estimated useful lives for the current and

comparative periods are as follows:

<b>Descriptions</b>	<b>Useful Lives</b>
Software, capitalized development cost	5 years
Other intangible assets	5 years or contract periods

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Amortization methods, useful lives and residual values are reviewed at each financial year-end and adjusted if appropriate.

### ***Investment Property***

Investment property is property held either to earn rental income or for capital appreciation or for both, but not for sale in the ordinary course of business, use in the production or supply of goods or services, or for administrative purposes.

Investment property is measured initially at cost. Transaction costs are included in the initial measurement. Subsequently, investment property is carried at depreciated cost less any accumulated impairment loss.

### ***Leased Assets***

#### ***Classification of a Lease***

A finance lease is a lease that transfers substantially all of the risks and rewards incidental to ownership of the leased asset from the lessor to the lessee; title to the asset may or may not transfer under such a lease. An operating lease is a lease other than a finance lease.

#### ***Lessee***

Under a finance lease, the lessee recognizes the leased asset and a liability for future lease payments. Upon initial recognition the leased asset is measured at an amount equal to the lower of its fair value and the present value of the minimum lease payments. Subsequent to initial recognition, the asset is accounted for in accordance with the accounting policy applicable to that asset.

Under an operating lease, the lessee recognizes the lease payments as expense over the lease term and does not recognize the leased asset in the consolidated statements of financial position.

#### ***Lessor***

Under a finance lease, the lessor recognizes a finance lease receivable. Over the lease term the lessor accrues interest income on the net investment. The receipts under the lease are allocated between reducing the net investment and recognizing finance income, so as to produce a constant rate of return on the net investment.

Under an operating lease, the lessor recognizes the lease payments as income over the lease term and the leased asset in the consolidated statements of financial position.

### ***Assets Held for Sale***

Non-current assets, or disposal groups comprising assets and liabilities, that are expected to be recovered primarily through sale rather than through continuing use, are classified as held for sale. Immediately before classification as held for sale, the assets, or components of a disposal group, are remeasured in accordance with our accounting policies. Thereafter generally the assets, or disposal group, are measured at the lower of their carrying amount and fair value less cost to sell. Impairment losses on initial classification as held for sale and subsequent gains or losses on remeasurement are recognized in profit or loss. Gains are not recognized in excess of any cumulative impairment loss.

### ***Impairment of Non-financial Assets***

The carrying amounts of our non-financial assets, other than investment property and deferred tax assets, are reviewed at each reporting date to determine whether there is any indication of impairment. If any such indication exists, then the asset's recoverable amount is estimated. For goodwill, and intangible assets that have indefinite useful lives or that are not yet available for use, the recoverable amount is estimated each year at the same time.

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The recoverable amount of an asset or cash-generating unit is the greater of its value in use and its fair value less costs to sell. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset. For the purpose of impairment testing, assets that cannot be tested individually are grouped together into the smallest group of assets that generates cash inflows from continuing use that are largely independent of the cash inflows of other assets or groups of assets (the cash-generating unit, or CGU).

An impairment loss is recognized if the carrying amount of an asset or its CGU exceeds its estimated recoverable amount. Impairment losses are recognized in profit or loss. Impairment losses recognized in respect of CGUs are allocated first to reduce the carrying amount of any goodwill allocated to the units, and then to reduce the carrying amounts of the other assets in the unit (group of units) on a pro rata basis.

An impairment loss in respect of goodwill is not reversed. In respect of other assets, impairment losses recognized in prior periods are assessed at each reporting date for any indications that the loss has decreased or no longer exists. An impairment loss is reversed if there has been a change in the estimates used to determine the recoverable amount. An impairment loss is reversed only to the extent that the asset's carrying amount does not exceed the carrying amount that would have been determined, net of depreciation or amortization, if no impairment loss had been recognized.

Goodwill that forms part of the carrying amount of an investment in an associate is not recognized separately, and therefore is not tested for impairment separately. Instead, the entire amount of the investment in an associate is tested for impairment as a single asset when there is objective evidence that the investment in an associate may be impaired.

***Non-Derivative Financial Liabilities***

Depending on commitments in a contract and definition of financial liabilities, the non-derivative financial liabilities are categorized as either at fair value through profit or loss or other financial liabilities.

Our equity-linked securities are hybrid financial products that combine features of debt securities and equity options. Their returns are based on the interest earned on the debt securities plus the gains or losses from the equity options. Equity-linked securities can be offered in Korea only by specially licensed brokers dealing in over-the-counter derivative products, and we offer these products through Shinhan Investment.

Under the accounting principle of fair value option, we measure the fair value of the equity-linked securities and reflect the changes in such fair value in net income. We compute the fair value of these securities primarily internally based on the Black and Scholes' option pricing model, except that in the case of overseas stocks, overseas stock indexes or other underlying assets, we use the average of valuations by two outside valuation firms hired by us.

***Financial Liabilities at Fair Value through Profit or Loss***

The financial liabilities at fair value through profit or loss include a financial liability held for trading or designated at fair value through profit or loss upon initial recognition. These financial liabilities are measured at fair value after initial recognition and changes in the fair value are recognized through profit or loss of the period. Costs attributable to the issuance or acquisition are immediately expensed in the period.

***Other Financial Liabilities***

The financial liabilities not classified as at fair value through profit or loss are classified into other financial liabilities. The liabilities are measured at a fair value minus cost relating to issuance upon initial recognition. Then, they are

carried at amortized cost, using the effective interest rate method.

Only when financial liabilities become extinct, or obligations in a contract are cancelled or terminated, are they derecognized from our consolidated statements of financial position.

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### ***Equity Instrument***

#### ***Capital Stock***

Capital stock is classified as equity. Incremental costs directly attributable to the transaction of stock are deducted, net of tax, from the equity.

#### ***Preference Share Capital***

Preference share capital is classified as equity if it is non-redeemable, or redeemable only at our option, and any dividends are discretionary. Dividends thereon are recognized as distributions within equity upon approval by our shareholders.

Preference share capital is classified as a liability if it is redeemable on a specific date or at the option of the shareholders, or if dividend payments are not discretionary. Dividends thereon are recognized as interest expense in profit or loss as accrued.

#### ***Hybrid Bond***

We classify issued financial instrument, or its component parts, on initial recognition as a financial liability or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability and an equity instrument. Hybrid bonds, in which we have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, are classified as equity instruments and presented in equity.

#### ***Non-controlling Interest***

Non-controlling interest, which means the equity is a subsidiary not attributable, directly or indirectly, to a parent, consists of the amount of those non-controlling interests at the date of the original combination calculated in accordance with IFRS 3(R) *Business Combination* and the non-controlling interests share of changes in equity since the date of the combination.

### ***Employee Benefits***

#### ***Short-term Employee Benefits***

Short-term employee benefit obligations are measured on an undiscounted basis and are expensed as the related service is provided.

A liability is recognized for the amount expected to be paid under short-term cash bonus or profit-sharing plans if we have a present legal or constructive obligation to pay this amount as a result of past service provided by the employee, and the obligation can be estimated reliably.

#### ***Other Long-term Employee Benefits***

Our net obligation in respect of long-term employee benefits other than pension plans is the amount of future benefit that employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value, and the fair value of any related assets is deducted. The discount rate is the yield at the reporting date on AA credit-rated bonds that have maturity dates approximating the terms of our obligations. The

calculation is performed using the projected unit credit method. Any actuarial gains and losses are recognized in profit or loss in the period in which they arise.

*Defined Benefit Plans*

A defined benefit plan is a post-employment benefit plan other than a defined contribution plan. Our net obligation in respect of defined benefit plans is calculated by estimating the amount of future benefit that



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employees have earned in return for their service in the current and prior periods; that benefit is discounted to determine its present value. The fair value of plan assets is deducted. The calculation is performed annually by an independent actuary using the projected unit credit method.

Remeasurements of the net defined benefit liability, which comprise actuarial gains and losses, the return on plan assets (excluding interest) and the effect of the asset ceiling (if any, excluding interest), are recognized immediately in other comprehensive income. We determine the net interest expense (income) on the net defined benefit liability (asset) for the period by applying the discount rate used to measure the defined benefit obligation at the beginning of the annual period to the then-net defined benefit liability (asset), taking into account any changes in the net defined benefit liability (asset) during the period as a result of contributions and benefit payments. Net interest expense and other expenses related to defined benefit plans are recognized in personnel expenses in profit or loss.

The discount rate is the yield at the reporting date on high-quality corporate bonds that have maturity dates approximating the terms of our obligations and that are denominated in the same currency in which the benefits are expected to be paid. We recognize service cost and net interest on the net defined benefit liability (asset) in profit or loss and remeasurement of the net defined benefit liability (asset) in other comprehensive income.

When the benefits of a plan are changed or when a plan is curtailed, the resulting change in benefit that relates to past service or the gain or loss on curtailment is recognized immediately in profit or loss. We recognize gains and losses on the settlement of a defined benefit plan when the settlement occurs.

*Defined Contribution Plans*

A defined contribution plan is a post-employment benefit plan under which an entity pays fixed contributions into a separate entity and will have no legal or constructive obligation to pay further amounts. Obligations for contributions to defined contribution pension plans are recognized as an employee benefit expense in profit or loss in the periods during which services are rendered by employees. Prepaid contributions are recognized as an asset to the extent that a cash refund or a reduction in future payments is available.

*Termination Benefits*

Termination benefits are recognized as an expense when we are committed demonstrably, without realistic possibility of withdrawal, to a formal detailed plan to either terminate employment before the normal retirement date, or to provide termination benefits as a result of an offer made to encourage voluntary redundancy. Termination benefits for voluntary redundancies are recognized as an expense if we have made an offer of voluntary redundancy, it is probable that the offer will be accepted, and the number of acceptances can be estimated reliably. If benefits are payable more than 12 months after the reporting period, then they are discounted to their present value.

*Share-based Payment Transactions*

The grant date fair value of share-based payment awards granted to employees is recognized as an employee expense, with a corresponding increase in equity, over the period that the employees unconditionally become entitled to the awards. The amount recognized as an expense is adjusted to reflect the number of awards for which the related service and non-market vesting conditions are expected to be met, such that the amount ultimately recognized as an expense is based on the number of awards that do meet the related service and non-market performance conditions at the vesting date. For share-based payment awards with non-vesting conditions, the grant date fair value of the share-based payment is measured to reflect such conditions and there is no true-up for differences between expected and actual outcomes.

The fair value of the amount payable to employees in respect of share appreciation rights, which are settled in cash, is recognized as an expense with a corresponding increase in liabilities, over the period that the employees unconditionally become entitled to payment. The liability is remeasured at each reporting date and at settlement date. Any changes in the fair value of the liability are recognized as personnel expense in profit or loss.

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### ***Provisions***

A provision is recognized if, as a result of a past event, we have a present legal or constructive obligation that can be estimated reliably, and it is probable that an outflow of economic benefits will be required to settle the obligation. Provisions are determined by discounting the expected future cash flows at a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the liability.

Provisions are reviewed at the end of each reporting period and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits will be required to settle the obligation, the provision is reversed.

### ***Financial Guarantee Contract***

Financial guarantees are contracts that require us to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the terms of a debt instrument. Financial guarantee liabilities are recognized initially at their fair value, and the initial fair value is amortized over the life of the financial guarantee. The financial guarantee liability is subsequently carried at the higher of this amortized amount and the present value of any expected payment when a payment under the guarantee has become probable. Financial guarantees are included within other liabilities.

### ***Financial Income and Expense***

#### ***Interest***

Interest income and expense are recognized in profit or loss using the effective interest method. The effective interest rate is the rate that exactly discounts the estimated future cash payments and receipts through the expected life of the financial asset or liability (or, where appropriate, a shorter period) to the carrying amount of the financial asset or liability. When calculating the effective interest rate, we estimate future cash flows considering all contractual terms of the financial instrument, but not future credit losses.

The calculation of the effective interest rate includes all fees and points paid or received that are an integral part of the effective interest rate. Transaction costs include incremental costs that are directly attributable to the acquisition or issue of a financial asset or liability.

#### ***Recognition of Interest Income on Impairment Losses***

Once an impairment loss has been recognized on a loan, although the accrual of interest in accordance with the contractual terms of the instrument is discontinued, interest income is recognized at the rate of interest that was used to discount estimated future cash flows for the purpose of measuring the impairment loss.

#### ***Fees and Commission***

Fees and commission income and expense that are integral to the effective interest rate on a financial asset or liability are included in the measurement of the effective interest rate.

Other fees and commission income, including account servicing fees, investment management fees, sales commission, placement fees and syndication fees, are recognized as the related services are performed. When a loan commitment is not expected to result in the draw-down of a loan, the related loan commitment fees are recognized on a straight-line

basis over the commitment period.

Other fees and commission expense relate mainly to transaction and service fees, which are expensed as the services are received.

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**Table of Contents***Dividends*

Dividend income is recognized when the right to receive income is established. Usually this is the ex-dividend date for equity securities.

*Customer Loyalty Program*

For customer loyalty programs, the fair value of the consideration received or receivable in respect of the initial sale is allocated between award credits ( points ) and other components of the fee and commission income. The Group provides awards, in the form of price discounts and by offering a variety of gifts. The fair value allocated to the points is estimated by reference to the fair value of the monetary and/or non-monetary benefits for which they could be redeemed. The fair value of the benefits is estimated taking into account the expected redemption rate and the timing of such expected redemptions. Such amount is deferred and recognized as unearned revenue. Unearned revenue is recognized only when the points are redeemed and the Group has fulfilled its obligations to provide the benefits. The amount of revenue recognized in those circumstances is based on the number of points that have been redeemed in exchange for benefits, relative to the total number of points that are expected to be redeemed.

*Income Tax*

Income tax expense comprises current and deferred tax. Current tax and deferred tax are recognized in profit or loss except to the extent that it relates to a business combination, or items recognized directly in equity or in other comprehensive income.

Current tax is the expected tax payable or receivable on the taxable income or loss for the year, using tax rates enacted or substantively enacted at the reporting date, and any adjustment to tax payable in respect of previous years.

Deferred tax is recognized in respect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for taxation purposes. Deferred tax is not recognized for the following temporary differences: the initial recognition of assets or liabilities in a transaction that is not a business combination and that affects neither accounting nor taxable profit or loss, and differences associated with investments in subsidiaries, associates, and interests in joint ventures, to the extent that we are able to control the timing of the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. In addition, deferred tax is not recognized for taxable temporary differences arising on the initial recognition of goodwill. Deferred tax is measured at the tax rates that are expected to be applied to temporary differences when they reverse, based on the laws that have been enacted or substantively enacted by the reporting date. Deferred tax assets and liabilities are offset if there is a legally enforceable right to offset current tax liabilities and assets, and they relate to income taxes levied by the same tax authority on the same taxable entity, or on different tax entities, but they intend to settle current tax liabilities and assets on a net basis or their tax assets and liabilities will be realized simultaneously.

A deferred tax asset is recognized for unused tax losses, tax credits and deductible temporary differences, to the extent that it is probable that future taxable profits will be available against which they can be utilized. Deferred tax assets are reviewed at each reporting date and are reduced to the extent that it is no longer probable that the related tax benefit will be realized.

We file our national income tax return with the Korean tax authorities under the consolidated corporate tax system, which allows us to make national income tax payments based on our and our wholly owned domestic subsidiaries consolidated profits or losses. Deferred taxes are measured based on the future tax benefits expected to be realized in consideration of the expected profits or losses of eligible companies in accordance with the consolidated corporate tax

system. Consolidated corporate tax amounts, once determined, are allocated to each of our subsidiaries and are used as a basis for the income taxes to be recorded in their separate financial statements.

**Table of Contents****Accounting for Trust Accounts**

We account for trust accounts separately from our group accounts under the Financial Investment Services and Capital Markets Act and thus the trust accounts are not included in the consolidated financial statements except those which are guaranteed as to principal (or as to both principal and interest) controlled by us, based on an evaluation of the substance of its relationship with us and the special purpose entity's risks and rewards. Funds transferred between a group account and a trust account are recognized as borrowings from trust accounts in other liabilities with fees for managing the accounts recognized as non-interest income by us.

**Earnings per Share**

We present basic and diluted earnings per share (EPS) data for our ordinary shares. Basic EPS is calculated by dividing the profit or loss attributable to an ordinary shareholder by the weighted average number of common shares outstanding during the period, adjusted for own shares held. Diluted EPS is determined by adjusting the profit or loss attributable to ordinary shareholders and the weighted average number of ordinary shares outstanding, adjusted for own shares held, for the effects of all dilutive potential ordinary shares, which comprise convertible notes and share options granted to employees.

**Average Balance Sheet and Volume and Rate Analysis****Average Balance Sheet and Related Interest**

The following table shows our average balances and interest rates, as well as the net interest spread, net interest margin and asset liability ratio, in 2012, 2013 and 2014.

	Year Ended December 31,								
	2012 <sup>(1)</sup>			2013 <sup>(1)</sup>			2014		
Average Balance <sup>(2)</sup>	Interest Income/Expense	Yield / Rate	Average Balance <sup>(2)</sup>	Interest Income/Expense	Yield / Rate	Average Balance <sup>(2)</sup>	Interest Income/Expense	Yield / Rate	

(In billions of Won, except percentages)

<b>Assets:</b>										
Interest-earning assets										
Due from banks	₩ 12,080	₩ 247	2.04%	₩ 13,917	₩ 201	1.44%	₩ 16,118	₩ 237	1.47%	
Trading assets	17,378	515	2.96	19,037	531	2.79	23,267	620	2.67	
Loans <sup>(3)</sup>										
Retail loans	70,974	3,847	5.42	75,069	3,487	4.65	79,642	3,340	4.19	
Corporate loans	102,800	5,280	5.14	105,482	4,664	4.42	110,460	4,465	4.04	
Public and other loans	3,591	195	5.43	2,821	131	4.64	2,343	100	4.27	
Loans to banks	5,215	153	2.93	4,824	122	2.54	4,296	106	2.47	
Credit card loans	17,508	1,834	10.48	17,436	1,764	10.12	17,574	1,703	9.69	
Total loans	200,088	11,309	5.65	205,632	10,168	4.94	214,315	9,714	4.53	
Securities <sup>(4)</sup>										
	30,566	1,154	3.78	30,471	985	3.23	28,105	826	2.94	

Available-for-sale financial assets									
Held-to-maturity financial assets	11,793	595	5.05	11,187	528	4.72	12,160	522	4.29
<b>Total securities</b>	<b>42,359</b>	<b>1,749</b>	<b>4.13</b>	<b>41,658</b>	<b>1,513</b>	<b>3.63</b>	<b>40,265</b>	<b>1,348</b>	<b>3.35</b>
Other interest-earning assets		179			178			142	
<b>Total interest-earning assets</b>	<b>₩ 271,905</b>	<b>₩ 13,999</b>	<b>5.15%</b>	<b>₩ 280,244</b>	<b>₩ 12,591</b>	<b>4.49%</b>	<b>₩ 293,965</b>	<b>₩ 12,061</b>	<b>₩ 4.10%</b>
Non-interest-earning assets									
Cash and due from banks	₩ 2,661			₩ 2,601			₩ 2,417		
Derivative assets	2,094			1,789			1,630		
Available-for-sale financial assets	4,389			4,046			3,333		
Property and equipment and intangible assets	7,732			7,393			7,375		
Other non-interest-earning assets	14,081			14,151			15,336		
<b>Total non-interest-earning assets</b>	<b>₩ 30,957</b>			<b>₩ 29,980</b>			<b>₩ 30,091</b>		
<b>Total assets</b>	<b>₩ 302,862</b>	<b>₩ 13,999</b>		<b>₩ 310,224</b>	<b>₩ 12,591</b>		<b>₩ 324,056</b>	<b>₩ 12,061</b>	



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	Year Ended December 31,									
	2012 <sup>(1)</sup>			2013 <sup>(1)</sup>			2014			
	Average	Interest		Average	Interest		Average	Interest		
	Balance <sup>(2)</sup>	Income/ ExpenseYield / Rate		Balance <sup>(2)</sup>	Income/ ExpenseYield / Rate		Balance <sup>(2)</sup>	Income/ ExpenseYield / Rate		
(In billions of Won, except percentages)										
<b>Liabilities:</b>										
Interest-bearing liabilities										
Deposits										
Demand deposits	₩ 17,233	₩ 118	0.68%	₩ 19,531	₩ 126	0.65%	₩ 21,871	₩ 124	0.57%	
Savings deposits	38,655	478	1.24	40,139	387	0.96	45,622	395	0.87	
Time deposits	109,743	3,980	3.63	112,134	3,367	3.00	112,469	2,902	2.58	
Other deposits	1,875	61	3.25	1,680	34	2.01	2,151	28	1.32	
Total interest-bearing deposits	167,506	4,637	2.77	173,484	3,914	2.26	182,113	3,449	1.89	
Trading Liabilities										
Borrowings	22,258	565	2.54	21,730	468	2.16	22,283	444	1.99	3
Debt securities issued	39,938	1,740	4.36	38,251	1,521	3.98	36,544	1,302	3.56	
Other interest-bearing liabilities	1,367	77	5.63	2,098	83	3.93	1,993	76	3.80	
<b>Total interest-bearing liabilities</b>	<b>₩ 231,069</b>	<b>₩ 7,019</b>	<b>3.04%</b>	<b>₩ 235,563</b>	<b>₩ 5,986</b>	<b>2.54%</b>	<b>₩ 242,936</b>	<b>₩ 5,271</b>	<b>2.17%</b>	
Non-interest-bearing liabilities										
Non-interest-bearing deposits										
Derivatives liabilities	₩ 2,459			₩ 2,669			₩ 2,872			
Insurance liabilities	1,811			1,788			1,793			
Other non-interest-bearing liabilities	12,053			14,592			16,714			
<b>Total non-interest-bearing liabilities</b>	<b>₩ 43,586</b>			<b>₩ 45,404</b>			<b>₩ 50,780</b>			
<b>Total liabilities</b>	<b>₩ 274,655</b>	<b>₩ 7,019</b>		<b>₩ 280,967</b>	<b>₩ 5,986</b>		<b>₩ 293,716</b>	<b>₩ 5,271</b>		
Total equity attributable to equity holder of the Group										
	25,728			26,974			28,620			
	2,479			2,283			1,720			

Non-controlling  
interest

<b>Total liabilities and equity</b>	<b>₩ 302,862</b>	<b>₩ 7,019</b>	<b>₩ 310,224</b>	<b>₩ 5,986</b>	<b>₩ 324,056</b>	<b>₩ 5,271</b>
Net interest spread <sup>(5)</sup>			2.11%		1.95%	1.93%
Net interest margin <sup>(6)</sup>			2.57%		2.36%	2.31%
Average asset liability ratio <sup>(7)</sup>			117.67%		118.97%	121.01%

*Notes:*

- (1) The amounts for 2012 and 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.
- (2) Average balances are based on (a) daily balances for Shinhan Bank and (b) quarterly balances for other subsidiaries.
- (3) Non-accruing loans are included in the respective average loan balances. Income on such non-accruing loans is no longer recognized from the date the loan is placed on nonaccrual status. We reclassify loans as accruing when interest (including default interest) and principal payments are current.
- (4) Average balance of and yield on securities are based on book value.
- (5) Represents the difference between the average rate of interest earned on interest-earning assets and the average rate of interest paid on interest-bearing liabilities.
- (6) Represents the ratio of net interest income to average interest-earning assets.
- (7) Represents the ratio of average interest-earning assets to average interest-bearing liabilities.

**Table of Contents****Analysis of Changes in Net Interest Income – Volume and Rate Analysis**

The following table provides an analysis of changes in interest income, interest expense and net interest income between changes in volume and changes in rates for (i) 2014 compared to 2013 and (ii) 2013 compared to 2012. Volume and rate variances have been calculated on the movement in average balances and the change in the interest rates on average interest-earning assets and average interest-bearing liabilities in proportion to absolute volume and rate change.

	<b>From 2013 to 2014</b>		
	<b>Interest Increase (Decrease) Due to Change in Volume</b>	<b>Rate</b>	<b>Change</b>
	<b>(In billions of Won)</b>		
<b>Increase (decrease) in interest income</b>			
Due from banks	₩ 32	₩ 4	₩ 36
Trading assets	114	(25)	89
Loans:			
Retail loans	205	(352)	(147)
Corporate loans	213	(412)	(199)
Public and other loans	(21)	(10)	(31)
Loans to banks	(13)	(3)	(16)
Credit card loans	14	(75)	(61)
Total loans	398	(852)	(454)
Securities:			
Available-for-sale financial assets	(73)	(86)	(159)
Held-to-maturity financial assets	44	(50)	(6)
Total securities	(29)	(136)	(165)
Other interest-earning assets		(36)	(36)
Total interest income	₩ 515	₩ (1,045)	₩ (530)
<b>Increase (decrease) in interest expense</b>			
Deposits:			
Demand deposits	₩ 14	₩ (16)	₩ (2)
Savings deposits	50	(42)	8
Time deposits	10	(475)	(465)
Other deposits	8	(14)	(6)
Total interest-bearing deposits	82	(547)	(465)
Borrowings	12	(36)	(24)
Debt securities issued	(66)	(153)	(219)
Other interest-bearing liabilities	(4)	(3)	(7)

Total interest expense	₩ 24	₩ (739)	₩ (715)
<b>Net increase (decrease) in net interest</b>	<b>₩ 491</b>	<b>₩ (306)</b>	<b>₩ 185</b>

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	<b>From 2012 to 2013</b>		
	<b>Interest Increase (Decrease) Due to Change in</b>		
	<b>Volume<sup>(1)</sup></b>	<b>Rate<sup>(1)</sup></b>	<b>Change</b>
	<b>(In billions of Won)</b>		
<b>Increase (decrease) in interest income</b>			
Due from banks	₩ 34	₩ (80)	₩ (46)
Trading assets	47	(31)	16
Loans:			
Retail loans	213	(573)	(360)
Corporate loans	135	(751)	(616)
Public and other loans	(38)	(26)	(64)
Loans to banks	(11)	(20)	(31)
Credit card loans	(7)	(63)	(70)
Total loans	₩ 292	₩ (1,433)	₩ (1,141)
Securities:			
Available-for-sale financial assets	(4)	(165)	(169)
Held-to-maturity financial assets	(30)	(37)	(67)
Total securities	(34)	(202)	(236)
Other interest-earning assets		(1)	(1)
Total interest income	₩ 339	₩ (1,747)	₩ (1,408)
<b>Increase (decrease) in interest expense</b>			
Deposits:			
Demand deposits	₩ 15	₩ (7)	₩ 8
Savings deposits	18	(109)	(91)
Time deposits	85	(698)	(613)
Other deposits	(6)	(21)	(27)
Total interest-bearing deposits	₩ 112	₩ (835)	₩ (723)
Borrowings	(13)	(84)	(97)
Debt securities issued	(71)	(148)	(219)
Other interest-bearing liabilities	33	(27)	6
Total interest expense	₩ 61	₩ (1,094)	₩ (1,033)
<b>Net increase (decrease) in net interest</b>	<b>₩ 278</b>	<b>₩ (653)</b>	<b>₩ (375)</b>

Note:

- (1) The amounts for 2012 and 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.

**Table of Contents****Results of Operations****2014 Compared to 2013**

The following table sets forth, for the periods indicated, the principal components of our operating income.

	<b>Year Ended December 31,</b>		
	<b>2013<sup>(1)</sup></b>	<b>2014</b>	<b>% Change</b>
<b>(In billions of Won, except percentages)</b>			
Net interest income	₩ 6,605	₩ 6,790	2.8%
Net fees and commission income	1,387	1,469	5.9
Net other operating income (expense)	(5,360)	(5,604)	4.6
Operating income	₩ 2,632	₩ 2,655	0.9%

*Note:*

- (1) The amounts for 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.

*Net Interest Income*

The following table shows, for the periods indicated, the principal components of our net interest income.

	<b>Year Ended December 31,</b>		
	<b>2013<sup>(1)</sup></b>	<b>2014</b>	<b>% Change</b>
<b>(In billions of Won, except percentages)</b>			
<b>Interest income:</b>			
Cash and due from banks	₩ 201	₩ 237	17.9%
Trading assets	493	583	18.3
Financial assets designated at fair value through profit or loss	38	37	(2.6)
Loans	10,168	9,714	(4.5)
Available-for-sale financial assets	985	826	(16.1)
Held-to-maturity financial assets	528	522	(1.1)
Other interest income	178	142	(20.2)
Total interest income	₩ 12,591	₩ 12,061	(4.2)%

Interest expense:

Deposits	₩ 3,914	₩ 3,449	(11.9)%
Borrowings	468	444	(5.1)
Debt securities issued	1,521	1,302	(14.4)
Other interest expense	83	76	(8.4)
<b>Total interest expense</b>	<b>₩ 5,986</b>	<b>₩ 5,271</b>	<b>(11.9)%</b>
Net interest income	₩ 6,605	₩ 6,790	2.8%
Net interest margin <sup>(2)</sup>	2.36%	2.31%	(2.0)%

*Notes:*

- (1) The amounts for 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.
- (2) Represents the ratio of net interest income to average interest-earning assets. See Average Balance Sheet and Volume and Rate Analysis Average Balance Sheet and Related Interest.



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*Interest income.* The 4.2% decrease in interest income was due primarily to a decrease in interest on loans. Interest on loans decreased by 4.5% from ₩10,168 billion in 2013 to ₩9,714 billion in 2014, primarily as a result of a decrease in the average lending rate from 4.94% in 2013 to 4.53% in 2014 largely as a result of a general decrease in market interest rates in reflection of the lowering of the base interest rate by the Bank of Korea and the ample liquidity in the Korean financial sector, which was partially offset by a 4.22% increase in the average balance of total loans from ₩205,632 billion in 2013 to ₩214,315 billion in 2014 due to an increase in the average balance of both retail and corporate loans following targeted loan growth in select strategic customer segments.

Interest income from retail loans decreased by 4.22% from ₩3,487 billion in 2013 to ₩3,340 billion in 2014, primarily due to a decrease in the average lending rate for retail loans from 4.65% in 2013 to 4.19% in 2014, which was partially offset by a 6.09% increase in the average balance of retail loans from ₩75,069 billion in 2013 to ₩79,642 billion in 2014. The average lending rate for retail loans decreased largely as a result of a decrease in the base rate set by the Bank of Korea, which largely determines the market rates for certificates of deposit, which in turn largely determines our lending rates for a substantial majority of our retail loans. The average balance of retail loans increased principally as a result of a continued increase in lending to borrowers with high credit profiles and government employees with relatively strong job security (such as police officers and firefighters) as part of our strategic initiative to increase the volume of lending while maintaining or improving the profit margin and asset quality for such lending, an increase in the volume of long-term housing rental deposit loans in tandem with a growing preference for long-term housing rental in lieu of home ownership due in part to the continued uncertainty in the Korean real property market, and a substantial increase in the volume of secured housing loans in the second half of 2014 following the series of Government plans to stimulate the general economy and the real estate market through various monetary, fiscal and deregulatory measures as announced in the second half of 2014.

Interest income from corporate loans decreased by 4.27% from ₩4,664 billion in 2013 to ₩4,465 billion in 2014, which was primarily due to a decrease in the average lending rate for corporate loans from 4.42% in 2013 to 4.04% in 2014, which was partially offset by a 4.72% increase in the average balance of such loans from ₩105,482 billion in 2013 to ₩110,460 billion in 2014. The average lending rate for corporate loans decreased largely as a result of a general decrease in market interest rates in reflection of the lowering of the base rate by the government and the ample liquidity in the Korean financial sector. The average balance of corporate loans increased principally as a result of an increase in loans to SOHO and small- and medium-sized enterprise borrowers with quality credit profiles as part of our strategic lending policies as well as the launch of new loan products for SOHO and small- and medium-sized enterprises in general at relatively affordable rates in line with the Government's policy initiative to assist and support such enterprises, as well as an increase in working capital loans to large corporations to meet their short-term financing needs.

*Interest expense.* Interest expense decreased by 11.9% from ₩5,986 billion in 2013 to ₩5,271 billion in 2014, due primarily to a 11.9% decrease in interest expense on deposits from ₩3,914 billion in 2013 to ₩3,449 billion in 2014 and a 14.4% decrease in interest expense on debt securities issued from ₩1,521 billion in 2013 to ₩1,302 billion in 2014.

The decrease in interest expense on deposits was due to a decrease in the average interest rate payable on deposits from 2.26% in 2013 to 1.89% in 2014, which was partially offset by a 4.97% increase in the average balance of deposits from ₩173,484 billion in 2013 to ₩182,113 billion in 2014. The increase in the average balance of deposits was primarily due to a 11.98% increase in the average balance of demand deposits from ₩19,531 billion in 2013 to ₩21,871 billion in 2014 and a 13.66% increase in the average balance of savings deposits from ₩40,139 billion in 2013 to ₩45,622 billion in 2014 while the average balance of time deposits, which represents the substantial majority of deposits, remained largely stable from ₩112,134 billion in 2013 to ₩112,469 billion in 2014. The increase in the average balance of demand deposits was largely due to an increase in newly opened demand deposit accounts

(including accounts for automatic deposit of salaries and credit card settlements) mainly as a result of our active cross-selling efforts, as well as the increased use of check cards. The

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increase in the average balance of savings deposits was largely due to an increase in savings deposits by government and government-affiliated agencies. The decrease in the average interest rate payable on deposits resulted mainly from a decrease in the average interest rate payable on time deposits from 3.00% in 2013 to 2.58% in 2014. The average interest rate payable on time deposits decreased largely as a result of a general decrease in market interest rates attributable to the decrease in the base interest rate set by the Bank of Korea and ample liquidity in the Korean financial sector.

The decrease in interest expense on debt securities issued was due to a decrease in the average interest rate payable on debt securities from 3.98% in 2013 to 3.56% in 2014, and a 4.46% decrease in the average balance of debt securities from ₩38,251 billion in 2013 to ₩36,544 billion in 2014. The average interest rate payable on debt securities issued decreased largely as a result of a general decrease in market interest rates in reflection of the lowering of the base rate by the Bank of Korea and the ample liquidity in the Korean financial sector. The average balance of debt securities issued decreased largely as a result of the increase in the average balance of deposits, which reduced our need to source funding through issuance of debt securities, which bear higher interest rates.

*Net interest margin.* Net interest margin represents the ratio of net interest income to the average balance of interest-earning assets. Our overall net interest margin decreased by five basis points from 2.36% in 2013 to 2.31% in 2014, due to a 4.90% increase in the average volume of interest-earning assets from ₩280,244 billion in 2013 to ₩293,965 billion in 2014 and a decrease by two basis points in net interest spread from 1.95% in 2013 to 1.93% in 2014. Net interest spread, which represents the difference between the average rate of interest earned on interest-earning assets and the average rate of interest paid on interest-bearing liabilities, decreased from 2013 to 2014 primarily due to a 39 basis points decrease in the average rate of interest receivable on interest-earning assets (principally consisting of loans) from 4.49% in 2013 to 4.10% in 2014 primarily resulting from the decrease in base interest rates set by the Bank of Korea from 2.50% in 2013 to 2.00% in 2014, which more than offset a 37 basis points decrease in the average rate of interest paid on interest-bearing liabilities from 2.54% in 2013 to 2.17% in 2014 primarily due to a decrease in the average interest rate payable on deposits from 2.26% in 2013 to 1.89% in 2014 and a decrease in the average interest rate payable on debt securities issued from 3.98% in 2013 to 3.56% in 2014, in each case, for reasons discussed above. In general, as was the case in 2013, a decrease in the base rates set by the Bank of Korea tend to decrease our net interest margin since our deposits (on which we pay interest) have, on average, a longer maturity profile than our loans (from which we receive interest) do and are therefore less sensitive to movements in base and market interest rates. See [Overview](#) [Interest Rates](#).

**Table of Contents***Fees and Commission Income (Expense), Net*

The following table shows, for the periods indicated, the principal components of our net fees and commission income.

	<b>Year Ended December 31,</b>		
	<b>2013</b>	<b>2014</b>	<b>% Change</b>
	<b>(In billions of Won, except percentages)</b>		
<b>Fees and commission income:</b>			
Credit placement fees	₩ 67	₩ 63	(6.0)%
Commission received as electronic charge receipt	132	135	2.3
Brokerage fees	329	321	(2.4)
Commission received as agency	213	191	(10.3)
Investment banking fees	45	50	11.1
Commission received in foreign exchange activities	143	143	
Asset management fees	51	61	19.6
Credit card fees	2,106	2,201	4.5
Others	404	396	(2.0)
<b>Total fees and commission income</b>	<b>₩ 3,490</b>	<b>₩ 3,561</b>	<b>2.0%</b>
<b>Fees and commission expense:</b>			
Credit-related fees	₩ 38	₩ 33	(13.2)%
Credit card fees	1,726	1,726	
Others	339	333	(1.8)
<b>Total fees and commission expense</b>	<b>2,103</b>	<b>2,092</b>	<b>(0.5)</b>
<b>Net fees and commission income</b>	<b>₩ 1,387</b>	<b>₩ 1,469</b>	<b>5.9%</b>

Net fees and commission income increased by 5.9% from ₩1,387 billion in 2013 to ₩1,469 billion in 2014, primarily as a result of a 4.5% increase in credit card fees from ₩2,106 billion in 2013 to ₩2,201 billion in 2014, which was partially offset by a 10.3% decrease in commission received as agency.

The increase in credit card fees was principally attributable to an increase in the average credit card balance, which was partially offset by a decrease in the rate of fees we charge on merchants. The decrease in commission received as agency was principally attributable to a result of a temporary suspension of telemarketing activities by Shinhan Card as part of a sanction from the financial regulators applicable to all credit card companies in Korea (including Shinhan Card) following the leakage of personal customer information by credit card companies, as well as a decrease in fees for asset-backed securitization services related to mobile phone installment receivables due to a reduction of such securitizations in following a change in telecommunication law in Korea.

**Table of Contents***Other Operating Income (Expense), Net*

The following table shows, for the periods indicated, the principal components of our net operating expense.

	<b>Year Ended December 31,</b>		
	<b>2013<sup>(1)</sup></b>	<b>2014</b>	<b>% Change</b>
<b>(In billions of Won, except percentages)</b>			
Net insurance loss	₩ (383)	₩ (413)	7.8%
Dividend income	156	176	12.8
Net trading income	75	262	N/M
Net foreign currency transaction gain	296	224	(24.3)
Net loss on financial instruments designated at fair value through profit or loss	(122)	(361)	N/M
Net gain on sale of available-for-sale financial assets	701	681	(2.9)
Impairment loss on financial assets	(1,340)	(1,174)	(12.4)
General and administrative expenses	(4,203)	(4,463)	6.2
Others	(540)	(536)	(0.7)
Other operating income (expense)	₩ (5,360)	₩ (5,604)	4.6%

*N/M = not meaningful*

*Note:*

(1) The amounts for 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.

Net other operating expenses increased by 4.6% to ₩5,604 billion in 2014 from ₩5,360 billion in 2013, primarily as a result of a 6.2% increase in general and administrative expenses and a significant increase in net loss on financial instruments designated at fair value through profit or loss, which were partially offset by a significant increase in net trading income and a 12.4% decrease in impairment loss on financial assets.

General and administrative expenses increased by 6.2% from ₩4,203 billion in 2013 to ₩4,463 billion in 2014 principally due to an increase in performance pays, an increase related to termination benefits arising from voluntary retirement programs and performance and an increase in taxes and dues related to the contribution of funds to a government-sponsored program to replace old credit card payment terminals for low-income merchants.

Net loss on financial instruments designated at fair value through profit or loss increased significantly from ₩122 billion in 2013 to ₩361 billion in 2014, largely as a result of a significant increase in valuation losses on equity-linked securities mainly as a result of an increase in volatility in the Korean stock market indices. However, the net economic effect from such loss is negligible since we hedge substantially all of our equity-linked securities and such loss is therefore offset for the most part by net trading income from valuation gains from related derivative products.

Net trading income increased significantly from ₩75 billion in 2013 to ₩262 billion in 2014, largely as a result of valuation gains on short-term financial instruments and trading gains from the disposal thereof following the decrease in the base and market interest rates.

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Impairment loss on financial assets decreased primarily for reasons further discussed below.

*Impairment Loss on Financial Assets*

The following table sets forth for the periods indicated the impairment loss by type of financial asset.

	Year Ended December 31,		
	2013	2014	% Change
	(In billions of Won, except percentages)		
Loans:			
Retail	₩ 140	₩ 153	9.3%
Corporate	613	358	(41.6)
Credit card	339	387	14.2
Others	(10)	(3)	(70.0)
Subtotal	1,082	895	(17.3)
Securities <sup>(1)</sup>	215	230	7.0
Others	43	49	14.0
Total impairment loss on financial assets	₩ 1,340	₩ 1,174	(12.4)%

*Note:*

(1) Consist of available-for-sale financial assets.

Impairment loss on financial assets decreased by 12.4% from ₩1,340 billion in 2013 to ₩1,174 billion in 2014 principally due to a 17.3% decrease in impairment on loans from ₩1,082 billion in 2013 to ₩895 billion in 2014, which mainly resulted from:

a 41.6% decrease in impairment loss on corporate loans from ₩613 billion in 2013 to ₩358 billion in 2014 principally due to a decrease in delinquency among corporate borrowers resulting from our enhanced risk management policy and ongoing efforts to increase the overall asset quality of our corporate loans by focusing on SOHOs and small- to medium- sized enterprises with high quality credit;

which was partially offset by:

a 14.2% increase in impairment loss on credit card loans from ₩339 billion in 2013 to ₩387 billion in 2014 principally due to an increase in allowance for credit card loan losses (largely resulting from an increase in the average balance of credit card receivables) and an increase in bad debt expenses (largely resulting from a reduction in recovery of written-off receivables due to aging); and

a 9.3% increase in impairment loss on retail loans from ₩140 billion in 2013 to ₩153 billion in 2014 principally due to the preemptive sale of loans showing signs of asset quality deterioration as part of the Bank's risk management policy to improve its overall asset quality.

*Income Tax Expense*

Income tax expense increased by 7.53% from ₩621 billion in 2013 to ₩668 billion in 2014 as a result of the increase in our taxable income. Our effective rate of income tax remained largely stable from 23.2% in 2013 to 23.3% in 2014.

*Net Income for the Period*

As a result of the foregoing, our net income for the period increased by 7.02% from ₩2,055 billion in 2013 to ₩2,200 billion in 2014.



**Table of Contents***Other Comprehensive Income for the Period*

	<b>Year Ended December 31,</b>		
	<b>2013<sup>(1)</sup></b>	<b>2014</b>	<b>% Change</b>
<b>(In billions of Won, except percentages)</b>			
<b>Items that will be reclassified to profit or loss:</b>			
Foreign currency translation differences for foreign operations	₩ (58)	₩ (13)	(77.6)%
Net change in fair value of available-for-sale financial assets	(269)	136	N/M
Equity in other comprehensive income of associates	(5)	6	N/M
Net change in unrealized fair value of cash flow hedges	6	(16)	N/M
Other Comprehensive income (loss) of separate account	(2)	6	N/M
	(328)	119	N/M
<b>Items that will not be reclassified to profit or loss:</b>			
Remeasurements of defined benefit liability	19	(155)	N/M
	19	(155)	N/M
<b>Total other comprehensive loss, net of income tax</b>	<b>₩ (309)</b>	<b>₩ (36)</b>	<b>(88.3)%</b>

*N/M = not meaningful*

*Note:*

(1) The amounts for 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.

Other comprehensive loss decreased by 88.3% to ₩36 billion in 2014 from ₩309 billion in 2013, principally due to valuation gains for debt instruments held by us following a decrease in the base and market interest rates, which more than offset a negative change in remeasurements of defined benefit liability, mainly related to changes in financial assumptions, including discount rates used in reflection of the lower base and market interest rates.

**2013 Compared to 2012**

The following table sets forth, for the periods indicated, the principal components of our operating income.

	<b>Year Ended December 31,</b>		
	<b>2012<sup>(1)</sup></b>	<b>2013<sup>(1)</sup></b>	<b>% Change</b>
<b>(In billions of Won, except percentages)</b>			
Net interest income	₩ 6,980	₩ 6,605	(5.4)%

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Net fees and commission income	1,543	1,387	(10.1)
Net other operating income (expense)	(5,347)	(5,360)	0.2
Operating income	₩ 3,176	₩ 2,632	(17.1)%

*Note:*

- (1) The amounts for 2012 and 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.

**Table of Contents***Net Interest Income*

The following table shows, for the periods indicated, the principal components of our net interest income.

	<b>Year Ended December 31,</b>		
	<b>2012<sup>(1)</sup></b>	<b>2013<sup>(1)</sup></b>	<b>% Change</b>
	<b>(In billions of Won, except percentages)</b>		
<b>Interest income:</b>			
Cash and due from banks	₩ 247	₩ 201	(18.6)%
Trading assets	489	493	0.8
Financial assets designated at fair value through profit or loss	26	38	46.2
Loans	11,309	10,168	(10.1)
Available-for-sale financial assets	1,154	985	(14.6)
Held-to-maturity financial assets	595	528	(11.3)
Other interest income	179	178	(0.6)
<b>Total interest income</b>	<b>₩ 13,999</b>	<b>₩ 12,591</b>	<b>(10.1)%</b>
<b>Interest expense:</b>			
Deposits	₩ 4,637	₩ 3,914	(15.6)%
Borrowings	565	468	(17.2)
Debt securities issued	1,740	1,521	(12.6)
Other interest expense	77	83	7.8
<b>Total interest expense</b>	<b>₩ 7,019</b>	<b>₩ 5,986</b>	<b>(14.7)%</b>
<b>Net interest income</b>	<b>₩ 6,980</b>	<b>₩ 6,605</b>	<b>(5.4)%</b>
<b>Net interest margin<sup>(2)</sup></b>	<b>2.57%</b>	<b>2.36%</b>	<b>(8.2)%</b>

*Notes:*

(1) The amounts for 2012 and 2013 have been restated to retroactively reflect changes in accounting policies regarding the classification of financial instruments held by us and correction of prior period errors as described in Note 48 of the notes to our consolidated financial statements.

(2) Represents the ratio of net interest income to average interest-earning assets. See Average Balance Sheet and Volume and Rate Analysis Average Balance Sheet and Related Interest.

*Interest income.* The 10.1% decrease in interest income was due primarily to a decrease in interest on loans. Interest on loans decreased by 10.1% from ₩11,309 billion in 2012 to ₩10,168 billion in 2013, primarily as a result of a decrease in the average lending rate from 5.65% in 2012 to 4.94% in 2013 largely as a result of a general decrease in market interest rates in reflection of the lowering of the base interest rate by the Bank of Korea and the ample liquidity in the Korean financial sector, which was partially offset by a 2.8% increase in the average balance of total loans from

₩200,088 billion in 2012 to ₩205,632 billion in 2013 due to an increase in the average balance of both retail and corporate loans following targeted loan growth in select strategic customer segments.

Interest on retail loans decreased by 9.4% from ₩3,847 billion in 2012 to ₩3,487 billion in 2013, primarily due to a decrease in the average lending rate for retail loans from 5.42% in 2012 to 4.65% in 2013, which was partially offset by a 5.8% increase in the average balance of retail loans from ₩70,974 billion in 2012 to ₩75,069 billion in 2013. The average lending rate for retail loans decreased largely as a result of a decrease in the base rate set by the Bank of Korea, which largely determines the market rates for certificates of deposit, which in turn largely determines our lending rates for a substantial majority of our retail loans. The average balance of retail loans increased principally as a result of an increase in the volume of long-term housing rental deposit loans in tandem with a growing preference for long-term housing rental in lieu of home ownership due in part to the continued uncertainty in the Korean real property market, as well as increased lending to borrowers

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with high credit profiles and government employees with relatively strong job security, such as police officers and firefighters, as part of our strategic initiative to increase the volume of lending while maintaining or improving the profit margin and asset quality for such lending.

Interest on corporate loans decreased by 11.7% from ₩5,280 billion in 2012 to ₩4,664 billion in 2013, which was primarily due to a decrease in the average lending rate for corporate loans from 5.14% in 2012 to 4.42% in 2013, which was partially offset by a 2.6% increase in the average balance of such loans from ₩102,800 billion in 2012 to ₩105,482 billion in 2013. The average lending rate for corporate loans decreased largely as a result of a general decrease in market interest rates in reflection of the lowering of the base rate by the government and the ample liquidity in the Korean financial sector. The average balance of corporate loans increased principally as a result of an increase in loans to SOHO and small- and medium-sized enterprise borrowers with quality credit profiles as part of our strategic lending policies as well as the launch of new loan products for SOHO and small- and medium-sized enterprises in general at relatively affordable rates in line with the Government's policy initiative to assist and support such enterprises, which more than offset a decrease in the balance of loans to large corporations due to the sale or write-off of a portion of such loans that were insolvent or at risk of insolvency as part our risk management efforts to improve the overall quality of our assets.

*Interest expense.* Interest expense decreased by 14.7% from ₩7,019 billion in 2012 to ₩5,986 billion in 2013, due primarily to a 15.6% decrease in interest expense on deposits from ₩4,637 billion in 2012 to ₩3,914 billion in 2013, a 17.2% decrease in interest expense on borrowings from ₩565 billion in 2012 to ₩468 billion in 2013 and a 12.6% decrease in interest expense on debt securities issued from ₩1,740 billion in 2012 to ₩1,521 billion in 2013.

The decrease in interest expense on deposits was due to a decrease in the average interest rate payable on deposits from 2.77% in 2012 to 2.26% in 2013, which was partially offset by a 3.6% increase in the average balance of deposits from ₩167,506 billion in 2012 to ₩173,484 billion in 2013. The increase in the average balance of deposits was primarily due to a 2.2% increase in the average balance of time deposits from ₩109,743 billion in 2012 to ₩112,134 billion in 2013, which was partially offset by a 10.4% decrease in the average balance of other deposits from ₩1,875 billion in 2012 to ₩1,680 billion in 2013. The overall increase in the average balance of time deposits was largely due to the growing preference among customers for higher-yielding deposit products such as time deposits (which generally offer relatively higher rates of interest compared to our other deposit products) in light of the continued low interest rate environment in Korea in 2013, as well as our efforts to maintain our customer base by offering competitive rates on time deposits. The average balance of other deposits, which principally consist of certificates of deposit, decreased primarily as a result of our efforts to replace a portion of certificates of deposit with regular customer deposits in order to improve our loan-to-deposit ratio since the former are not classified as deposits for purposes of computing such ratio. The decrease in the average interest rate payable on deposits resulted mainly from a decrease in the average interest rate payable on time deposits from 3.63% in 2012 to 3.00% in 2013 and a decrease in the average interest rate payable on other deposits from 3.25% in 2012 to 2.01% in 2013. The average interest rate payable on time deposits decreased largely as a result of a general decrease in market interest rates attributable to the decrease in the base interest rate set by the Bank of Korea and ample liquidity in the Korean financial sector. The average interest rate payable on other deposits also decreased largely as a result of the general decrease in market interest rates in 2013, as well as our efforts to decrease the volume of our certificates of deposit by offering lower rates thereon.

The decrease in interest expense on borrowings was due to a 2.4% decrease in the average balance of borrowings from ₩22,258 billion in 2012 to ₩21,730 billion in 2013 and a decrease on the average interest rate payable on borrowings from 2.54% in 2012 to 2.16% in 2013. The average balance of borrowings decreased largely as a result of the increase in the average balance of deposits and greater availability of funding through capital markets in tandem with the ample liquidity in the Korean financial sector, both of which reduced our need to source funding through borrowings.

The average interest rate payable on borrowings decreased largely due to the general decrease in market interest rates in 2013 and our active efforts to reduce borrowings with relatively high interest rates through repayment.

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The decrease in interest expense on debt securities issued was due to a decrease in the average interest rate payable on debt securities from 4.36% in 2012 to 3.98% in 2013, and a 4.2% decrease in the average balance of debt securities from ₩39,938 billion in 2012 to ₩38,251 billion in 2013. The average interest rate payable on debt securities issued decreased largely as a result of a general decrease in market interest rates in reflection of the lowering of the base rate by the Bank of Korea and the ample liquidity in the Korean financial sector. The average balance of debt securities issued decreased largely as a result of the increase in the average balance of deposits, which reduced our need to source funding through issuance of debt securities, which bear higher interest rates.

*Net interest margin.* Net interest margin represents the ratio of net interest income to the average balance of interest-earning assets. Our overall net interest margin decreased by 21 basis points from 2.57% in 2012 to 2.36% in 2013, due to a decrease by 16 basis points in net interest spread from 2.11% in 2012 to 1.95% in 2013, which more than offset a 3.1% increase in the average volume of interest-earning assets from ₩271,905 billion in 2012 to ₩280,244 billion in 2013. Net interest spread, which represents the difference between the average rate of interest earned on interest-earning assets and the average rate of interest paid on interest-bearing liabilities, decreased from 2012 to 2013 primarily due to a 66 basis points decrease in the average rate of interest receivable on interest-earning assets (principally consisting of loans) from 5.15% in 2012 to 4.49% in 2013 primarily resulting from the decrease in base interest rates set by the Bank of Korea in 2012 from 2.75% in 2012 to 2.50% in 2013, which more than offset a 50 basis points decrease in the average rate of interest paid on interest-bearing liabilities from 3.04% in 2012 to 2.54% in 2013 primarily due to a decrease in the average interest rate payable on deposits from 2.77% in 2012 to 2.26% in 2013 and a decrease in the average interest rate payable on debt securities issued from 4.36% in 2012 to 3.98% in 2013, in each case, for reasons discussed above. In general, as was the case in 2012, a decrease in the base rates set by the Bank of Korea tend to decrease our net interest margin since our deposits (on which we pay interest) have, on average, a longer maturity profile than our loans (from which we receive interest) do and are therefore less sensitive to movements in base and market interest rates. See [Overview](#) [Interest Rates](#).

*Fees and Commission Income (Expense), Net*

The following table shows, for the periods indicated, the principal components of our net fees and commission income.

	Year Ended December 31,		
	2012	2013	% Change
	(In billions of Won, except percentages)		
Fees and commission income:			
Credit placement fees	₩ 58	₩ 67	15.5%
Commission received as electronic charge receipt	134	132	(1.5)
Brokerage fees	354	329	(7.1)
Commission received as agency	211	213	0.9
Investment banking fees	70	45	(35.7)
Commission received in foreign exchange activities	148	143	(3.4)
Asset management fees	47	51	8.5
Credit card fees	2,071	2,106	1.7
Others	398	404	1.5
<b>Total fees and commission income</b>	<b>₩ 3,491</b>	<b>₩ 3,490</b>	

Fees and commission expense:

Credit-related fees	₩ 38	₩ 38
Credit card fees	1,678	