

SHINHAN FINANCIAL GROUP CO LTD

Form 20-F

April 29, 2016

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As filed with the Securities and Exchange Commission on April 29, 2016

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, 2015

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 04513, 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 04513, 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 are to the Republic of Korea. All references to the Government are to the government of the Republic of Korea. References to the Financial Services Commission are to the Financial Services Commission of Korea, and references to the Financial Supervisory Service are to the Financial Supervisory Service of Korea, the executive body of the Financial Services Commission.

The fiscal year for us and our subsidiaries ends on December 31 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 ₩1,169.3 to US\$1.00, which was the noon buying rate in the City of New York on December 31, 2015 for cable transfers according to the H.10 statistical release of the Federal Reserve Board (the Noon Buying Rate). On April 12, 2016, the Noon Buying Rate was ₩1,144.5 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

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could cause actual results to differ materially from those described in the forward-looking statements. This 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****PART I****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, 2011, 2012, 2013, 2014 and 2015 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, 2011, 2012, 2013, 2014 and 2015 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**

	Year Ended December 31,					
	2011	2012	2013	2014	2015	2015 <sup>(1)</sup>
	(In billions of Won and millions of US\$, except per common share data)					
Interest income	₩ 13,781	₩ 13,999	₩ 12,591	₩ 12,061	₩ 11,130	\$ 9,518
Interest expense	(6,701)	(7,019)	(5,986)	(5,271)	(4,437)	(3,794)
<b>Net interest income</b>	<b>7,080</b>	<b>6,980</b>	<b>6,605</b>	<b>6,790</b>	<b>6,693</b>	<b>5,724</b>
Fees and commission income	3,557	3,491	3,490	3,561	3,897	3,332
Fees and commission expense	(1,798)	(1,948)	(2,103)	(2,091)	(2,276)	(1,946)
<b>Net fees and commission income</b>	<b>1,759</b>	<b>1,543</b>	<b>1,387</b>	<b>1,469</b>	<b>1,621</b>	<b>1,386</b>
Net insurance loss	(119)	(211)	(383)	(413)	(432)	(370)
Dividend income	209	174	156	176	308	264
Net trading income (loss)	(132)	608	75	262	(344)	(294)
Net foreign currency transaction gain	14	280	296	224	78	67

Net gain (loss) on financial instruments designated at fair value through profit or loss	172	(532)	(122)	(361)	460	393
Net gain on sale of available-for-sale financial assets	846	536	701	681	772	661
Impairment losses on financial assets	(983)	(1,416)	(1,340)	(1,174)	(1,264)	(1,081)
General and administrative expenses	(3,983)	(4,062)	(4,203)	(4,463)	(4,475)	(3,827)
Net other operating expenses	(538)	(724)	(540)	(536)	(444)	(380)
<b>Operating income</b>	<b>4,325</b>	<b>3,176</b>	<b>2,632</b>	<b>2,655</b>	<b>2,973</b>	<b>2,543</b>
Equity method income	58	28	7	31	21	18
Other non-operating income (loss), net	(38)	25	37	182	147	125
<b>Profit before income taxes</b>	<b>4,345</b>	<b>3,229</b>	<b>2,676</b>	<b>2,868</b>	<b>3,141</b>	<b>2,686</b>

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	Year Ended December 31,					
	2011	2012	2013	2014	2015	2015 <sup>(1)</sup>
	(In billions of Won and millions of US\$, except per common share data)					
Income tax expense	(957)	(739)	(621)	(668)	(695)	(594)
<b>Profit for the year</b>	<b>₩ 3,388</b>	<b>₩ 2,490</b>	<b>₩ 2,055</b>	<b>₩ 2,200</b>	<b>₩ 2,446</b>	<b>\$ 2,092</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	₩ 16	₩ (85)	₩ (58)	₩ (13)	₩ (6)	\$ (6)
Net change in unrealized fair value of available-for-sale financial assets	(461)	13	(269)	136	(266)	(227)
Equity in other comprehensive income of associates	3	4	(5)	6	12	10
Net change in unrealized fair value of cash flow hedges	1	16	6	(16)	3	3
Other comprehensive income (loss) of separate account		1	(2)	6	2	2
	(441)	(51)	(328)	119	(255)	(218)
Items that will never be reclassified to profit or loss:						
Remeasurements of defined benefit liability	(115)		19	(154)	(82)	(70)
	(115)		19	(154)	(82)	(70)
Total other comprehensive loss, net of income tax	(556)	(51)	(309)	(36)	(337)	(288)
<b>Total comprehensive income for the year</b>	<b>₩ 2,832</b>	<b>₩ 2,439</b>	<b>₩ 1,746</b>	<b>₩ 2,164</b>	<b>₩ 2,109</b>	<b>\$ 1,804</b>
Net income attributable to:						
Equity holders of the Group	₩ 3,215	₩ 2,320	₩ 1,898	₩ 2,081	₩ 2,367	\$ 2,024
Non-controlling interest	173	170	157	119	79	68
Total comprehensive income attributable to:						
Equity holders of the Group	2,660	2,267	1,591	2,046	2,034	1,740
Non-controlling interest	172	172	155	118	75	64
Earnings per share:						
Basic earnings per share in Won and US\$ <sup>(2)</sup>	6,195	4,681	3,810	4,195	4,789	4.10
	6,065	4,681	3,810	4,195	4,789	4.10

Dilutive earnings per share in Won and  
US\$(<sup>3</sup>)

*Notes:*

- (1) Won amounts are expressed in U.S. Dollar at the rate of ₩1,169.3 to US\$1.00, the Noon Buying Rate in effect on December 31, 2015 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.
- (2) 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.

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- (3) 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**

	2011	2012	2013	2014	2015	2015 <sup>(1)</sup>
	(In billions of Won and millions of US\$, except per common share data)					
<b>Assets</b>						
Cash and due from banks	₩ 14,731	₩ 13,507	₩ 16,473	₩ 20,585	₩ 22,024	\$ 18,836
Trading assets	11,954	16,654	18,033	24,362	22,638	19,361
Financial assets designated at fair value through profit or loss	1,801	2,542	3,361	2,737	3,244	2,774
Derivative assets	2,319	2,171	1,717	1,568	1,995	1,706
Loans, net	192,573	200,289	205,723	221,618	246,441	210,760
Available-for-sale financial assets	34,106	36,284	33,597	31,418	33,966	29,048
Held-to-maturity financial assets	11,895	11,660	11,031	13,373	16,192	13,848
Property and equipment, net	2,994	3,108	3,214	3,147	3,039	2,599
Intangible assets, net	4,203	4,195	4,226	4,153	4,275	3,656
Investments in associates	249	299	329	342	393	336
Current tax receivable	9	14	6	11	10	8
Deferred tax assets	29	100	196	228	164	140
Investment properties, net	275	779	690	268	209	178
Other assets, net	10,888	13,283	12,451	14,203	15,946	13,637
Assets held for sale	16	54	243	9	4	3
<b>Total assets</b>	<b>₩ 288,042</b>	<b>₩ 304,939</b>	<b>₩ 311,290</b>	<b>₩ 338,022</b>	<b>₩ 370,540</b>	<b>\$ 316,890</b>
<b>Liabilities</b>						
Deposits	₩ 163,016	₩ 173,296	₩ 178,810	₩ 193,710	₩ 217,676	\$ 186,160
Trading liabilities	704	1,371	1,258	2,689	2,136	1,826
Financial liabilities designated at fair value through profit or loss	3,298	4,822	5,909	8,996	8,916	7,625
Derivative liabilities	1,972	1,904	2,019	1,718	2,599	2,223
Borrowings	20,033	19,537	20,143	22,974	21,734	18,587
Debt securities issued	39,737	38,838	37,491	37,335	41,221	35,253
Liability for defined benefit obligations	275	222	118	309	226	193
Provisions	870	748	750	694	699	598
Current tax payable	568	254	239	257	142	121
Deferred tax liabilities		42	15	10	11	10

Liabilities under insurance contracts	10,867	13,420	15,662	17,776	20,058	17,154
Other liabilities	19,843	21,574	19,021	21,040	23,312	19,936
<b>Total liabilities</b>	<b>₩ 261,183</b>	<b>₩ 276,028</b>	<b>₩ 281,435</b>	<b>₩ 307,507</b>	<b>₩ 338,730</b>	<b>\$ 289,686</b>



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	2011	2012	2013	2014	2015	2015 <sup>(1)</sup>
	(In billions of Won and millions of US\$, except per common share data)					
<b>Equity</b>						
Capital stock	₩ 2,645	₩ 2,645	₩ 2,645	₩ 2,645	₩ 2,645	\$ 2,262
Hybrid bond	239	537	537	537	737	630
Capital surplus	9,887	9,887	9,887	9,887	9,887	8,456
Capital adjustments	(393)	(393)	(393)	(393)	(424)	(362)
Accumulated other comprehensive income	1,189	980	673	638	305	261
Retained earnings	10,830	12,714	14,189	15,869	17,690	15,127
Total equity attributable to equity holders of the Group	24,397	26,370	27,538	29,184	30,840	26,374
Non-controlling interest	2,462	2,541	2,317	1,331	970	830
<b>Total equity</b>	<b>₩ 26,859</b>	<b>₩ 28,911</b>	<b>₩ 29,855</b>	<b>₩ 30,515</b>	<b>₩ 31,810</b>	<b>\$ 27,204</b>
<b>Total liabilities and equity</b>	<b>₩ 288,042</b>	<b>₩ 304,939</b>	<b>₩ 311,290</b>	<b>₩ 338,022</b>	<b>₩ 370,540</b>	<b>\$ 316,890</b>

Note:

- (1) Won amounts are expressed in U.S. Dollar at the rate of ₩1,169.3 to US\$1.00, the Noon Buying Rate in effect on December 31, 2015 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,				
	2011	2012	2013	2014	2015
	(In Won and US\$)				
Cash dividends per share of common stock:					
In Korean Won	₩ 750	₩ 700	₩ 650	₩ 950	₩ 1,200
In U.S. Dollars <sup>(1)</sup>	\$ 0.65	\$ 0.66	\$ 0.62	\$ 0.87	\$ 1.03
Cash dividends per share of preferred stock:					
In Korean Won	₩ 4,996	₩ 5,580	₩ 5,580	₩ 5,580	₩ 5,580
In U.S. Dollars <sup>(1)</sup>	\$ 4.31	\$ 5.25	\$ 5.29	\$ 5.12	\$ 4.77

Note:

- (1) Won amounts for 2011, 2012, 2013, 2014 and 2015 are expressed in U.S. Dollar at the rate of ₩1,158.5, ₩1,063.2, ₩1,055.3, ₩1,090.9, and ₩1,169.3 respectively, to US\$1.00, the Noon Buying Rate in effect on December 31, 2011, 2012, 2013, 2014 and 2015, 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 and Other Data***

	2011	Year Ended December 31,				2015
		2012	2013	2014	(Percentages)	
Net income attributable to the Group as a percentage of:						
Average total assets <sup>(1)</sup>	1.09%	0.82%	0.66%	0.68%	0.62%	
Average total Group stockholders' equity <sup>(1)</sup>	10.89	8.83	7.03	7.25	7.08	
Dividend payout ratio <sup>(2)</sup>	20.39	16.77	19.47	24.66	30.25	
Net interest spread <sup>(3)</sup>	2.34	2.11	1.95	1.93	1.78	
Net interest margin <sup>(4)</sup>	2.80	2.57	2.36	2.31	2.08	
Efficiency ratio <sup>(5)</sup>	82.53	85.98	88.25	87.31	88.15	
Cost-to-income ratio <sup>(6)</sup>	44.79	47.45	52.41	55.32	52.74	
Cost-to-average assets ratio <sup>(1)(7)</sup>	7.23	6.54	6.48	6.09	6.56	
Equity to average asset ratio <sup>(1)(8)</sup>	9.97	9.31	9.43	9.36	8.72	

*Notes:*

- (1) Average total assets, liabilities and stockholders' equity are based on (a) daily balances for Shinhan Bank and (b) quarterly balances for other subsidiaries.
- (2) Represents the ratio of total dividends declared on common and preferred stock and hybrid bonds as a percentage of net income attributable to the Group.
- (3) Represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.
- (4) Represents the ratio of net interest income to average interest-earning assets.
- (5) 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:

	2011	Year Ended December 31,				2015
		2012	2013	2014	(In billions of Won, except percentages)	
Non-interest expense (A)	₩ 20,505	₩ 19,802	₩ 20,100	₩ 19,733	₩ 23,368	
<i>Divided by</i>						
The sum of net interest income and non-interest income (B)	24,845	23,031	22,776	22,601	26,509	
Net interest income	7,080	6,980	6,605	6,790	6,693	
Non-interest income	17,765	16,051	16,171	15,811	19,816	

Efficiency ratio ((A) as a  
percentage  
of (B))

82.53%

85.98%

88.25%

87.31%

88.15%

- (6) 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.
- (7) Represents the ratio of non-interest expense to average total assets.
- (8) Represents the ratio of average stockholders' equity to average total assets.

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

	As of December 31,				
	2011	2012	2013	2014	2015
	(In billions of Won, except percentages)				
Total gross loans	₩ 195,055	₩ 202,916	₩ 207,987	₩ 223,879	₩ 248,429
Total allowance for loan losses	₩ 2,577	₩ 2,800	₩ 2,476	₩ 2,501	₩ 2,318
Allowance for loan losses as a percentage of total loans	1.32%	1.38%	1.19%	1.12%	0.93%
Impaired loans <sup>(1)</sup>	₩ 2,457	₩ 2,658	₩ 2,386	₩ 2,127	₩ 1,902
Impaired loans as a percentage of total loans	1.26%	1.31%	1.15%	0.95%	0.77%
Allowance as a percentage of impaired loans	104.88%	105.34%	103.77%	117.58%	121.87%
Total non-performing loans <sup>(2)</sup>	₩ 1,416	₩ 1,695	₩ 1,197	₩ 1,286	₩ 1,333
Non-performing loans as a percentage of total loans	0.73%	0.84%	0.58%	0.57%	0.54%
Allowance as a percentage of total assets	0.89%	0.92%	0.80%	0.74%	0.63%

*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,				
	2011	2012	2013	2014	2015
	(Percentages)				
Group BIS ratio <sup>(1)</sup>	11.41%	12.46%	13.43%	13.05%	13.39%
Total capital adequacy ratio of Shinhan Bank	15.26	15.83	16.29	15.43	14.75
Adjusted equity capital ratio of Shinhan Card <sup>(2)</sup>	25.81	27.43	30.41	29.69	28.88
Solvency ratio for Shinhan Life Insurance <sup>(3)</sup>	324.02	287.70	253.06	230.69	204.19

*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.

	<b>As of December 31,</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
	<b>(In millions of Won, except percentages)</b>		
Risk-weighted assets	₩ 190,716,648	₩ 198,832,860	₩ 203,274,542
Total risk-adjusted capital	₩ 25,605,827	₩ 25,937,968	₩ 27,216,448
Tier I capital	₩ 21,538,399	₩ 22,174,353	₩ 23,194,191
Tier I common equity capital	₩ 19,119,612	₩ 20,678,971	₩ 21,882,816
Capital adequacy ratio (%)	13.43%	13.05%	13.39%
Tier I capital adequacy ratio (%)	11.29%	11.15%	11.41%
Common equity capital adequacy ratio (%)	10.03%	10.40%	10.77%

**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.

<b>Year Ended December 31,</b>	<b>At End of Period Average<sup>(1)</sup></b>		<b>High</b>	<b>Low</b>
	<b>(Won per US\$1.00)</b>			
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
2015	1,169.3	1,133.7	1,196.4	1,063.0
October	1,140.5	1,143.2	1,180.0	1,120.9
November	1,149.4	1,153.5	1,172.7	1,136.5
December	1,169.3	1,169.9	1,188.0	1,140.7
2016 (through April 12)	1,144.5	1,182.9	1,242.6	1,138.9
January	1,210.0	1,203.3	1,217.0	1,190.4
February	1,238.1	1,216.2	1,242.6	1,186.1
March	1,229.6	1,181.6	1,229.6	1,138.9
April (through April 12)	1,144.5	1,150.5	1,158.4	1,142.0

Source: Federal Reserve Board

Note:

- (1) The average rate for annual and interim periods were calculated by taking the simple average of the Noon Buying Rates on the last day of each month during the relevant period. The average rates for the monthly periods (or portion thereof) were calculated by taking the simple average of the daily Noon Buying Rates during the relevant month (or portion thereof).

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, 2015, which was ₩1,169.3 to US\$1.00. On April 12, 2016, the Noon Buying Rate in effect was ₩1,144.5 to US\$1.00.



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

Not applicable.

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

Not applicable.

### **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 uncertainty about economic and political conditions in Europe, signs of cooling economy for China and the continuing geopolitical and social instability in various parts of the Middle East, including Iraq, Syria and Yemen, as well as in the former republics of the Soviet Union, including Russia and Ukraine, 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, volatility in the real estate market, rising household debt, potential declines in productivity due to aging demographics and low birth rates, 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. For example, in 2011 and 2012, the continuing slump in the real estate market and the shipbuilding industry led to increased delinquency among our corporate borrowers in the construction, real estate leasing, shipbuilding and shipping industries, and in certain cases, even insolvency, workouts, recovery proceedings and/or voluntary arrangements with creditors, as was the case for the current and former member companies of the STX Group, Keangnam Enterprises Co., Ltd., Dongbu Steel Co., Ltd., and Sambu Construction Co.,

Ltd. During the same period, the sustained slump in the real estate market also led to increased delinquency among our retail borrowers, and in particular, borrowers with collective loans for pre-sale of newly constructed apartment units.

Accordingly, Shinhan Bank's delinquency ratio (based on delinquency of one or more month and net of charge-offs and loan sales) increased from 0.48% as of December 31, 2010 to 0.60% as of December 31, 2011

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and 0.61% as of December 31, 2012. However, primarily due to a modest rebound in the housing market recently and 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, Shinhan Bank's delinquency ratio decreased to 0.39% as of December 31, 2013 and further to 0.31% as of December 31, 2014, and remained stable at 0.33% as of December 31, 2015. There is no assurance, however, that Shinhan Bank will not experience further loan losses from borrowers in the troubled industries since the quality of loans to such borrowers may further deteriorate due to the continued slump in these industries or for other reasons. As for Shinhan Card, its delinquency ratio under the Financial Services Commission guidelines increased from 2.01% as of December 31, 2010 to 2.27% as of December 31, 2011, and further to 2.64% as of December 31, 2012 largely as a result of an increase in its assets, before stabilizing and decreasing to 2.15%, 2.18% and 1.69% as of December 31, 2013, 2014 and 2015, 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.

Moreover, as was the case during the global financial crisis of 2008-2009, 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 other 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, 2015, Korea had six 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

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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 lending rates to stay competitive, which could lead to a decrease in its net interest margins and outweigh any potential 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.

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 enterprises (which are subject to revision every three years) 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. Most recently, in November 2015, the Government announced a further reduction in the merchant fees chargeable to small- and medium-sized enterprises with effect from January 31, 2016, and this is expected to place downward pressure on Shinhan Card's results of operations for 2016 and beyond. 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.



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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 and the Government's privatization efforts may also add competition in the markets in which we and our subsidiaries conduct business. A number of significant mergers and acquisitions in the industry have taken place in Korea over the past decade, including the acquisition of Hanmi Bank by an affiliate of Citibank in 2004, Standard Chartered Bank's acquisition of Korea First Bank in 2005, Chohung Bank's merger with Shinhan Bank in 2006, and Hana Financial Group's acquisition of Korea Exchange Bank in 2012 and the resulting merger of Hana Bank and Korea Exchange Bank in September 2015. Moreover, in 2014, pursuant to the implementation of the Government's privatization plan with respect to Woori Finance Holdings (now merged into Woori Bank) and its former subsidiaries, Woori Financial, Woori Asset Management and Woori F&I were acquired by KB Financial Group, Kiwoom Securities and Daishin Securities, respectively, and Woori Investment & Securities, Woori Aviva Life Insurance and Woori FG Savings Bank were acquired by NongHyup Financial Group. In 2015, the Government decided to sell a 30% to 40% interest in Woori Bank to multiple investors in separate blocks ranging from 4% to 10% each. Although such attempts have stalled, most recently in January 2016 when discussions with three Saudi Arabian sovereign funds broke off, the Government is expected to continue efforts to sell minority stakes of Woori Bank. In addition, in October 2014, the Government's ownership interest in the holding companies of Kwangju Bank and Kyongnam Bank were acquired by JB Financial Group and BS Financial Group (now BNK Financial Group), respectively. In the securities brokerage sector, Mirae Asset agreed in January 2016 to acquire KDB Daewoo Securities, which, if successfully consummated, will create the largest brokerage company in Korea by assets. 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. We expect that such consolidation and other structural changes in the financial industry will continue. Other financial institutions may seek to acquire or merge with other entities, and the financial institutions resulting from such consolidation may, by virtue of their increased size and business scope, provide greater competition for us. Increased competition and continuing consolidation may lead to decreased margins, resulting in a material adverse impact on our future profitability.

Regulatory reforms and the general modernization of business practices in Korea have also led to increased competition among financial institutions in Korea. From early 2009, financial investment companies with a dealing license and/or brokerage license are allowed to provide secondary services in connection with securities investments such as settlement and remittance services relating to customer deposits. In addition, in the second half of 2015, the Financial Services Commission began to take steps to adopt the account switch service, which allows customers to manage or switch their automatic payment transfer accounts in a more convenient way. For example, the Financial Services Commission introduced the integrated automatic payment transfer management system, which enables customers to change the bank account through which automatic payment transfers are made by following simple steps online or visiting a bank branch, with the banks being responsible for implementing the change should the customer decide to switch banks. Prior to the introduction of the account switch service, customers had the onus of making arrangements with each of the involved banks as well as the payment recipient to make the change. Under the new system, it is expected that customers will find it easier to switch from one bank to another. Currently, the service only applies to limited types of payment transfers, but the Financial Services Commission plans to expand the service with respect to all types of payment transfers by June 2016. Furthermore, effective March 2016, the Financial Services Commission introduced the individual savings account (ISA) system, as part of its efforts to lower the regulatory barrier between the banking and securities sectors. The ISA is an integrated account that enables account holders to manage a number of different financial products, including cash deposits, funds and securities investment accounts, from a single account, the income from which will be eligible for tax benefits. Since this new system does not allow an individual to hold multiple ISA accounts, competition among banks and securities firms to retain existing

customers and attract new customers is expected to intensify. As a result, Shinhan Bank may face difficulties in increasing or retaining its



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deposits, which in turn may result in an increase in its cost of funding and a decrease in its settlement and remittance service fee revenue. As the reform of the financial sector continues, competition may become more intense among existing banks, insurance companies, securities companies and other financial organizations, and may lead to significant changes in the current Korean financial market.

Furthermore, as the Korean economy further develops and new business opportunities arise, more competitors may enter the financial services industry. For example, as online service providers and technology companies with large-scale user networks, such as Kakao Corp., NAVER and Samsung Electronics, recently 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 and mobile payment service providers. Also, 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. In addition, the Government recently announced its plans to allow Internet-only banks to operate in Korea. As of the date hereof, two business consortiums, Kakao consortium and KT consortium, have been granted preliminary permission by the Government to operate Internet-only banks. These consortiums are expected to apply for final permission during the second half of 2016 and commence operations within six months of the final permission being granted by the Government. Internet-only banks may have advantages over traditional banks as the former can pass savings in labor and overhead costs to their customers by offering higher interest rates on deposit accounts, lower loan costs and reduced service fees. Accordingly, commercial banks will likely face 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.

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, whose minimum requirements were phased in sequentially from December 1, 2013 through full implementation by January 1, 2015, 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 is currently implementing the Basel III requirements relating to liquidity coverage ratio and capital conservation buffer, each of which will be fully phased in by January 1, 2019. Furthermore, the Financial Services Commission announced that it would implement the Basel III requirements relating to countercyclical capital buffer, which was initially set at 0% on March 30, 2016 but may be subject to change upon quarterly review by the Financial Services Commission. However, there is no assurance that these measures will have the effect of curbing 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. For further details on the capital requirements applicable to us, see [Item 4.B. Business Overview](#) [Supervision and Regulation](#) [Principal Regulations Applicable to Financial Holding Companies](#) [Capital Adequacy](#).

If, despite our efforts to adapt to the changing macroeconomic environment and comply with new regulations, 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 common equity Tier I capital adequacy ratio of 4.5%, a Tier I capital adequacy ratio of 6.0% and a total capital

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(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 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 equity ratio of 100%, 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. Under Basel III, Tier I capital is defined to include common equity Tier I and additional Tier I capital. Common equity Tier I capital is a new category of capital primarily consisting of common stock, capital surplus, retained earnings and other comprehensive income (progressively phased into the capital ratio calculation over several years). The new minimum capital requirements, including the minimum common equity Tier I requirement of 4.5% and additional mandatory capital conservation buffer requirement of 2.5%, are currently being implemented in phases until January 1, 2019. Additional discretionary countercyclical capital buffer requirements are also expected to be phased in, which will range at the discretion of national regulators between 0% and 2.5% of risk-weighted assets. Basel III also introduces a minimum leverage ratio requirement. In January 2016, the Group of Central Bank Governors and Heads of Supervision, the oversight body of the Basel Committee, (i) endorsed a new market risk framework that will take effect from 2019 by revising the standards on minimum capital requirements for market risk, (ii) agreed to complete its work to address the problem of excessive variability in risk-weighted assets by the end of 2016, and (iii) agreed on the use of a Tier I definition of capital for the calculation of the leverage ratio and the minimum leverage ratio level of 3%. The final calibration of the leverage ratio and any further adjustments to its definition are currently expected to be completed within 2016, and full compliance therewith is expected to be required beginning January 1, 2018.

In order to implement the capital requirements under Basel III in Korea, the Regulation on the Supervision of the Banking Business was amended, effective December 1, 2013. Under the amended Regulation on the Supervision of the Banking Business, effective from January 1, 2015, commercial banks in Korea are required to maintain a minimum common equity Tier I ratio of 4.5%, a minimum Tier I capital ratio of 6.0% and a minimum total capital (BIS) ratio of 8.0%. The Regulation on the Supervision of the Banking Business was further amended on December 26, 2014, to implement the liquidity coverage ratio requirements under Basel III in increments of 5% annually, from 80% as of January 1, 2015 to 100% as of January 1, 2019. Capital conservation buffer requirements are also being phased in from January 1, 2016 in increments of 0.625% annually, to the effect that commercial banks in Korea will be required to maintain a capital conservation buffer of 2.5% as of January 1, 2019. 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. The Financial Services Commission also announced that it would implement the Basel III requirements relating to countercyclical capital buffer, which was initially set at 0% on March 30, 2016 but may be subject to change upon quarterly review by the Financial Services Commission. Most recently, in December 2015, the Financial Services Commission designated us, Hana Financial Group, KB Financial Group and NongHyup Financial Group as domestic systemically important bank holding companies and Woori Bank as a domestic systemically important bank and introduced more stringent capital

requirements for these financial

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institutions. According to these new regulations, such financial institutions are required to maintain an additional capital buffer of 0.25% starting on January 1, 2016, with such buffer to increase by 0.25% annually to 1.00% by January 1, 2019.

We and our banking subsidiaries are currently, and have been, in full compliance with Basel III requirements as implemented in Korea since its introduction in December 2013. However, there is no assurance that we will continue to be able to be in compliance with Basel III requirements. New requirements under Basel III may require an increase in the credit risk capital requirements in the future, which may require us or our subsidiaries to either improve asset quality or raise additional capital. In addition, 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 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 was set at 60% as of January 1, 2015 and thereafter rises in annual increments 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 annual increments 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 operations.

We and our subsidiaries also raise funds in capital markets and borrow from other financial institutions, the cost of which depends on market rates and the general availability of credit and the terms of which may limit our

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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.

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 our cost of funding, limit our access to capital markets and other borrowings, or require us to provide additional credit enhancement in financial transactions, 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 operations 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 to 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 exchange rates may cause difficulty in obtaining foreign currency-denominated financing in the 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 2009, 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. Between 2009 and 2014, the base interest rate set by the Bank of Korea remained within the band between 2.00% and 3.25%. In an effort to support Korea's economy in light of the recent slowdown in Korea's growth and uncertain global economic prospects, the Bank of Korea reduced the base interest rate to 1.75% in March 2015 and further reduced such rate to the historic low of 1.50% in June 2015, which has since remained unchanged. 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



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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 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 correlates. A decision to adjust the base interest rate is subject to many policy considerations as well as market factors, 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 different maturity structure for our assets and liabilities as discussed above. In contrast, 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 Banking Services – Small- and Medium-sized Enterprises Banking ). Our loans (before allowance for loan losses and deferred loan origination costs and fees) to such enterprises amounted to ₩55,062 billion as of December 31, 2013, ₩59,889 billion as of December 31, 2014 and ₩67,336 billion as of December 31, 2015, representing 26.5%, 26.8% and 27.1%, respectively, of our total loan portfolio as of such dates.

Compared to loans to large corporations, which tend to be better capitalized and better able to weather business downturns, 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 banks to judge the level of risk

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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. 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, Southeast Asia 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 conservative lending policy, have led to a fluctuation in the asset quality of our loans to this segment. As of December 31, 2013, 2014 and 2015, Shinhan Bank's delinquent loans to small- and medium-sized enterprises were ~~₩320 billion~~, ~~₩322 billion~~ and ~~₩308 billion~~, respectively, representing delinquency ratios (net of charge-offs and loan sales) of 0.55%, 0.53%, and 0.46% respectively. If the ongoing difficulties in the Korean or global economy were to continue or aggravate, the delinquency ratio for our loans to small- and medium-sized enterprises may rise.

Of particular concern is our significant exposure to enterprises in the real estate and leasing and construction industries. As of December 31, 2015, Shinhan Bank had outstanding loans (before allowance for loan losses and deferred loan origination costs and fees) to enterprises in the real estate and leasing and construction industries (many of which are small- and medium-sized enterprises) of ₩19,061 billion and ₩2,797 billion, respectively, representing 9.0% and 1.3%, 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, and those in the petrochemical industries, which have recently been facing challenges due to declining fuel prices.

The enterprises in the real estate development and construction industries in Korea, which are heavily concentrated in the housing market, continue to experience difficulties despite the Government's policy measures designed to stimulate the real estate market and a moderate recovery in demand in the housing market, due to ongoing economic sluggishness in Korea and globally and the demographic changes in the Korean population. We also have 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, as a result, the liquidity and cash flow of these borrowers deteriorate. 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.



**Table of Contents*****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, 2015, the secured portion of Shinhan Bank's loans (before allowance for loan losses and deferred loan origination costs and fees) amounted to ₩98,645 billion, or 49.1% 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, if the real estate market in Korea experiences a downturn, 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 10 to 14 months 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, 2015, the total outstanding amount of Shinhan Bank's real estate project financing-related exposure was approximately ₩1.6 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, this may have an adverse effect on 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 10 largest corporate exposures as of December 31, 2015, three 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 ₩21,359 billion, or 15.1%, of its total exposures. As of that date, Shinhan Bank's single largest outstanding exposure to a main debtor group amounted to ₩4,166 billion, or 2.9%, of its total exposures. Largely due to the continued stagnation in the shipbuilding and construction industries, in 2013, current and

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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 Keangnam Enterprises Co., Ltd., a large construction company in Korea, entered into workout proceedings in the same year and subsequently filed for recovery proceedings in March 2015. Dongbu Steel Co., Ltd. and Sambu Construction Co., Ltd. also experienced significant hardship and entered into workout or recovery proceedings in 2015. Additionally, in October 2015, creditors of Daewoo Shipbuilding & Marine Engineering Co., led by Korea Development Bank, announced a restructuring plan that includes additional cash injection and extensive streamlining measures. Partly as a result of its active past efforts to reduce exposure to the shipbuilding and construction sectors, Shinhan Bank currently has limited exposure to the aforementioned troubled companies. However, if the credit quality of Shinhan Bank's exposure to large corporations, including those in the main debtor groups, declines, Shinhan Bank may be required to record additional loan loss provisions in respect of loans and impairment losses in respect of securities, which would adversely affect its financial condition, results of operations and capital adequacy. Shinhan Bank cannot assure you that the allowances it has 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.

A limited number of the main debtor groups to which Shinhan Bank has credit exposure are subject to restructuring programs or are 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, if the Government decides to pursue an aggressive restructuring policy with respect to distressed companies, Korean commercial banks, including Shinhan Bank, may face a temporary rise in delinquencies and an intensified pressure for additional provisioning. Furthermore, bankruptcies or financial difficulties of large corporations, including *chaebol* groups, may have the adverse ripple effect of triggering delinquencies and impairment of Shinhan Bank's loans to small- and medium-sized enterprises that supply parts or labor to such corporations. If Shinhan Bank experiences future losses from its exposure to large corporations, including *chaebol* groups, it may have a material adverse impact on Shinhan Bank's 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.

***The asset quality of our retail loan portfolio may deteriorate.***

In recent years, consumer debt, including lending to households and small unincorporated businesses, has continued to increase in Korea. Shinhan Bank's portfolio of retail loans is comprised of two principal product types, namely secured retail loans (which are primarily comprised of mortgage and home equity loans secured by real estate) and general purpose loans (which are unsecured loans and tend to carry a higher credit risk). As of December 31, 2015, Shinhan Bank's retail loan portfolio (before allowance for loan losses and deferred loan origination costs and fees) was ₩90,426 billion, or 42.9% of its total loans outstanding. As of December 31, 2013, 2014 and 2015, Shinhan Bank's non-performing retail loans were ₩132 billion, ₩141 billion and ₩148 billion, respectively, representing non-performing loan ratios (net of charge-offs and loan sales) of 0.18%, 0.18% and 0.16%, respectively.

Our large exposure to consumer debt means that we are exposed to changes in economic conditions affecting Korean consumers. For example, a rise in unemployment, an increase in interest rates or a decline in housing prices in Korea could adversely affect the ability of consumers to make payments and increase the likelihood of potential defaults. Economic difficulties in Korea that hurt consumers could result in increasing delinquencies and a decline in the asset quality of the our household loan portfolio, which may in turn require us to record higher provisions for credit loss and charge-offs and may materially and adversely affect our financial condition and results of operations.





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***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 notes 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, 2015, we had aggregate guarantees and acceptances of ₩13,120 billion, for which we provided allowances for losses of ₩80 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 the ships in time or otherwise default under the 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 ₩88 billion as of December 31, 2015. 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, 2013, 2014 and 2015, Shinhan Card's interest-earning credit card assets amounted to ₩19,626 billion, ₩20,550 billion and ₩21,323 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 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.

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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 January 2015, the Government further expanded the definition of a small- and medium-sized merchant to include those with annual sales of more than ₩200 million and up to ₩300 million, and imposed a cap on fees chargeable to such merchants at 2.0% with respect to credit cards. Most recently, in November 2015, the Government announced a further reduction in the merchant fees chargeable to small- and medium-sized enterprises with respect to credit cards, effective January 31, 2016, from 2.0% to 1.3% for merchants with annual sales of more than ₩200 million and up to ₩300 million, and from 1.5% to 0.8% for merchants with annual sales of up to ₩200 million. Pursuant to the Specialized Credit Financial Business Act, the rates of fees chargeable to merchants are subject to review and revision every three years.

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. These activities are described in Item 4.B. Business Overview Our Principal Activities Other 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, 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.

*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

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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 of 1950, as amended (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.

***Our risk management policies and procedures may not be fully effective at all times.***

In the course of our operations, we must manage a number of risks, such as credit risks, market risks and operational risks. We seek to monitor and manage our risk exposures through a comprehensive risk management platform, encompassing centralized risk management organization and credit evaluation systems, reporting and monitoring systems, early warning systems and other risk management infrastructure, using a variety of risk management strategies and techniques. See Item 4.B. Business Overview Risk Management. Although we

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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.

***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. 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. While we vigilantly protect customer data through encryption and other security programs and have made substantial investments to build and upgrade our systems and defenses to address the growing threats from cyber-attacks, there is no assurance that such data will not be subject to future security breaches. In addition, there can be no assurance that we will not experience a leakage of customer information or other security breaches as a result of illegal activities by our employees, outside consultants or hackers, or otherwise.

For example, in March 2013, we experienced a temporary interruption in providing online financial services due to large-scale cyber-attacks by unidentified sources on the security systems of major broadcasting networks and financial institutions in Korea. The interruption of our online financial services lasted approximately 90 minutes, after which our online system resumed without further malfunction. 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) and imposed disciplinary actions against five of Shinhan Bank's employees and three of Jeju Bank's employees. We do not believe such incident resulted in any material loss or leakage of customer information or other sensitive data.

Major financial institutions in Korea have also fallen victim to large-scale data leakage in the past. 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



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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.

Other than the cyber security attack in March 2013 as discussed above, we have not experienced any material security breaches in the past, including any similar large scale leakage of customer information. 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. We are fully committed to maintaining the highest 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 have obtained the Information Security Management System certification for most of 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 and is designed to provide early warning alerts to enable prompt action by us. We also provide intensive employee training to our information technology staff and other employees on cyber security 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 ₩3 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 smart phones 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 group-wide 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, given the unpredictable and continually evolving nature of cyber security threats due to advances in technology or other reasons, there is no assurance 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.

The public is developing heightened awareness about the importance of keeping their personal data private, and the financial regulators are placing greater emphasis on data protection by financial service providers. For example, under the Personal Information Protection Act, as amended in July 2015, financial institutions, as personal information manager, may not collect, store, maintain, utilize or provide resident registration numbers of their customers, unless other laws or regulations specifically request or permit the management of resident registration numbers. Further, under the Use and Protection of Credit Information Act, as amended in March 2015, a financial institution has a higher duty to protect all information that it collects from its customers and to treat such information as credit information. Such regulations have considerably restricted a financial institution's ability to transfer or provide the information to its affiliate or holding company, and treble damages can be imposed on a financial institution for a leakage of such information. In addition, under the Electronic Financial Transaction Act, as last amended in January 2016, a financial institution is primarily responsible for compensating its customers harmed by the financial institution's cyber security breach, even if the breach is not directly attributable to the financial institution. We maintain an integrated system that closely monitors customer information to ensure compliance with data protection laws and regulations.

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

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scrutiny and related sanctions, more stringent 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 operations 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 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. In addition, Shinhan Card and our other subsidiaries have established a fraud detection system that identifies any questionable transactions based on deviations from a customer's conventional transaction patterns.

Partly as a result of these efforts, the claims that Shinhan Card received in 2015 in relation to voice phishing amounted only to an aggregate amount of ₩0.37 billion from 11 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

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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 operations and financial condition.

### ***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. See Item 8.A. Consolidated Statements and Other Financial Information – Legal Proceedings. These types of proceedings may expose us to substantial monetary and/or reputational 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.

While we plan to rigorously defend our positions in the lawsuits or other regulatory proceedings against us, it is difficult to predict the final outcome of such cases. 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 and other proceedings may have a material adverse effect on our business, financial condition and results of operations.

### **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.

Upon implementation of the Government-proposed Financial Consumer Protection Act (currently pending at the National Assembly's subcommittee for review of the bill), financial instrument distributors will be subject to heightened investor protection measures, including stricter distribution guidelines, improved financial dispute resolution system, increased liability for damages borne by direct financial instrument distributors and newly imposed penalty surcharges. 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 are being 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

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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 Supervisory Service may ask the Financial Services Commission to order, among other things, cancellations of authorization, permission or registration of the business, suspensions of a part or all of the business, closures of branch offices, recommendations for dismissal of officers or suspensions of officers from performing their duties, or may order, among other things, institutional warnings, institutional cautions, reprimanding warnings on officers, cautionary warnings on officers or cautions on officers. 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 imposed on us or our subsidiaries could adversely impact our reputation, business, results of operations or financial condition.

*The 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. As part of these initiatives, the Financial Supervisory Service has recently encouraged banks in Korea to increase lending to small- and medium-sized enterprises in order to ease the financial burden on such enterprises amid sluggish economic recovery, and partly as a result of government policy, in February 2015, banks in Korea announced their commitment to increase lending to small- and medium-sized enterprises by ₩38.4 trillion in the aggregate (comprised of a ₩19.9 trillion commitment by major commercial banks, ₩6.8 trillion commitment by regional banks and a ₩11.7 trillion commitment by government-controlled policy banks) by the end of 2015 in anticipation of growing liquidity difficulties among such enterprises in light of the sustained sluggishness of the general economy. The financial regulators have also 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. In addition, 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 response to an increasing level of consumer debt and amid concerns over the debt-servicing capacity of retail borrowers if interest rates were to rise, the Financial Services Commission announced in February 2014 that it plans to increase the proportion of fixed interest rate loans and installment principal repayment-based loans within the total 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 fixed interest rate loans was set at 20%, 35%, 37.5% and 40% and the target proportion for installment principal repayment-based housing loans was set at 20%, 35%, 40% and 45%, each by the end of 2014, 2015, 2016 and 2017, respectively. In addition, an expanded tax deduction limit for interest

repayment is granted for loans with maturity of 10 years or more (compared to 15 years or more prior to this plan). The Financial Services Commission announced that it would examine whether banks meet their targets on an annual basis.



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In furtherance of the policy to expand the proportion of fixed rate housing loans, the Financial Services Commission implemented Relief Debt Conversion program from March 24 to March 27, 2015 and from March 30 to April 3, 2015, respectively, 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 maximum loan-to-value ratio of 70% (irrespective of the location of the property) and the maximum debt-to-income ratio of 60% (only in respect of apartment units located in the greater Seoul metropolitan area, subject to certain exceptions). 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 ₩31.5 trillion to fixed rate loans, of which Shinhan Bank accounted for approximately 13.6%. Due in large part to such initiatives, fixed interest rate loans and installment principal repayment-based loans accounted for 33.6% and 37.5%, respectively, of the total housing loans extended by commercial banks in Korea as of September 30, 2015, according to data published by the Government in December 2015. Fixed interest rate and installment principal repayment-based housing loans accounted for 36.2% and 39.1%, respectively, of the housing loans extended by Shinhan Bank as of December 31, 2015, exceeding the Government's target proportions for 2015.

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. Due to the prevailing interest rate environment and other market conditions, we also may not be able to sell or otherwise dispose of the mortgage backed securities in the market or otherwise in amounts or at prices commercially reasonable to us. In addition, as a result of this program we may incur additional costs from recalibrating our asset portfolio and asset-liability management policy. Any of these developments could adversely affect our results of operations and financial condition.

We, on a voluntary basis, may factor the existence of the Government's 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 arrangement, such as by strengthening its loan review and post-lending monitoring processes. However, we cannot assure you that such arrangement did not or will not, or similar or other government-led initiatives in the future will not, result in a suboptimal allocation of our loan portfolio from a risk-reward perspective compared to what we would have allocated based on purely commercial decisions in the absence of such initiatives. The Government may implement similar or other initiatives in the future to spur the overall economy or encourage the growth of targeted industries or relief to certain segments of the population. Specifically, the Government may introduce lending-related initiatives or enforce existing ones in a heightened fashion during times when small- and medium-sized enterprises or low-income households on average are facing an increased level of financial distress or vulnerability due to an economic downturn, which makes lending to them in the volume and the manner suggested by the Government even riskier and less commercially desirable. Accordingly, such policy-driven lending may create 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, which may have an adverse effect on our business, financial condition and results of operations.

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*The Government may also encourage 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 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, to deal with a growing number of non-performing loans in the wake of the global financial crisis of 2008-2009, the Government sponsored the establishment of United Asset Management Company Ltd. ( UAMCO ) in October 2009 through capital contributions from six major policy and commercial banks, namely Shinhan Bank, Kookmin Bank, KEB Hana Bank, Industrial Bank of Korea, Woori Bank and Nonghyup Bank. Shinhan Bank has committed to contribute ₩175 billion of capital to UAMCO, of which ₩85 billion has been contributed to date. As of the date hereof, Shinhan Bank holds a 17.5% equity interest in UAMCO, while five other policy and commercial banks each holds an interest ranging from 15.0% to 17.5%.

UAMCO seeks to achieve financial improvement of struggling companies through a wide range of restructuring programs, including debt restructuring, capital injection, asset sales, corporate reorganization, workouts and liquidation and bankruptcy proceedings. UAMCO is the largest purchaser in Korea of non-performing financial assets generally. Shinhan Bank sold non-performing assets to UAMCO in the amount of ₩89.8 billion, ₩326.1 billion and ₩39.1 billion in 2013, 2014 and 2015, respectively.

The Government originally planned to dispose of UAMCO during 2015 and establish a new company that specializes in corporate restructuring, but the Government scrapped such plans and instead decided to reorganize UAMCO and expand its restructuring business. As part of an effort to strengthen its balance sheet, UAMCO has recently announced its intention to receive additional capital contributions from two new shareholders, Korea Development Bank and the Export-Import Bank of Korea, and two of the existing shareholders, Woori Bank and Nonghyup Bank, by the end of June 2016. With an enlarged capital base following the planned capital contributions, it is expected that UAMCO will play a more active role in the restructuring of the Korean corporate sector. The Government is also considering an amendment of the Financial Investment Services and Capital Markets Act of Korea to facilitate the business activities of UAMCO.

If UAMCO is successful in its expanded restructuring activities, it is anticipated that financial institutions including us will be able to further enhance their financial soundness by transferring more non-performing loans to UAMCO rather than directly engaging in the restructuring activities of the troubled borrowers. However, Shinhan Bank or other banks may be requested by the Government to make additional capital contributions or loans to UAMCO, which may entail unanticipated costs. Additionally, given the generally poor quality of our non-performing assets, there is no assurance that we will be able to sell such assets held by us to UAMCO on commercially reasonable terms and on a timely basis. Furthermore, there is no assurance that in furtherance of similar or other policy objectives, the Government may not request or otherwise encourage us or 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, financial condition and results of operations.



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*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 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. In addition, amid a prolonged slump in the housing market in Korea, in April 2013, the Government announced the Real Estate Comprehensive Countermeasure, which provides, among other things, for (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. Furthermore, in February 2014, the Financial Services Commission announced that it plans to increase the proportion of fixed interest rate loans and installment principal repayment-based loans within the total housing loans extended by commercial banks. See [The Government may encourage targeted lending to certain sectors in furtherance of policy objectives, and we may take this factor into account.](#) In addition, in order to rationalize the regulations on the housing loans, the Financial Supervisory Service provided the administrative instructions in July 2014 that all financial institutions including banks under the Banking Act are subject to the maximum loan-to-value ratio of 70% (irrespective of the location of the property) and the maximum debt-to-income ratio of 60% (only in respect of apartment units located in the greater Seoul metropolitan area, subject to certain exceptions), from August 1, 2014. 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 growth in 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 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. In contrast, 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.

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**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 investors' 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 have an adverse impact on Korea's economy in the future include, among others:

continued volatility or deterioration in Korea's credit and capital markets;

difficulties in the financial sectors in Europe, China and elsewhere and increased sovereign default risks in select countries and the resulting adverse effects on the global financial markets;

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

adverse changes or volatility in foreign currency reserve levels, commodity prices (including oil prices), exchange rates (including fluctuation of the U.S. Dollar, the Euro or the Yen exchange rates or revaluation of the Chinese Renminbi), interest rates, inflation rates or stock markets;

increasing levels of household debt;

increasing delinquencies and credit defaults by retail and small- and medium-sized enterprise borrowers;

continuing adverse conditions in the economies of countries and regions that are important export markets for Korea, such as the United States, Europe, Japan and China, or in emerging market economies in Asia or elsewhere;

the economic impact of any pending or future free trade agreements;

social and labor unrest;

further decreases in the market prices of Korean real estate;

increases in social expenditures to support an aging population in Korea or decreases in economic productivity due to the declining population size in Korea;

geopolitical uncertainty and risk of further attacks by terrorist groups around the world, including the actions of the so-called Islamic State ;

the occurrence of severe health epidemics in Korea and other parts of the world, including the recent Ebola and Middle East Respiratory Syndrome (MERS) outbreaks;

deterioration in economic or diplomatic relations between Korea and its trading partners or allies, including deterioration resulting from territorial or trade disputes or disagreements in foreign policy;

political uncertainty or increasing strife among or within political parties in Korea, and political gridlock within the government or in the legislature, which prevents or disrupts timely and effective policy making;

hostilities involving oil-producing countries in the Middle East and North Africa and any material disruption in the supply of oil or increase in the price of oil; and

the occurrence of natural or man-made disasters in Korea (such as the sinking of the Sewol ferry in April 2014, which significantly dampened consumer sentiment in Korea for months) and other parts of the world, particularly in trading partners of Korea.



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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:

On February 7, 2016, North Korea launched a rocket, claimed by them to be carrying a satellite intended for scientific observation. The launch was widely suspected by the international community to be a cover for testing a long-range missile capable of carrying a nuclear warhead. On February 18, 2016, U.S. President Barack Obama signed into law mandatory sanctions on North Korea to punish it for its recent nuclear and missile tests, human rights violations and cyber crimes. The bill, which marks the first measure by the United States to exclusively target North Korea, is intended to seize the assets of anyone engaging in business related to North Korea's weapons program, and authorizes US\$50 million over five years to transmit radio broadcasts into the country and support humanitarian assistance projects. On March 2, 2016, the United Nations Security Council voted unanimously to adopt a resolution to impose sanctions against North Korea, which include inspection of all cargo going to and from North Korea, a ban on all weapons trade and the expulsion of North Korean diplomats who engage in illicit activities. Also, on March 4, 2016, the European Union announced that it would expand its sanctions on North Korea, adding additional companies and individuals to its list of sanction targets.

On January 6, 2016, North Korea announced that it had successfully conducted its first hydrogen bomb test, hours after international monitors detected a 5.1 magnitude earthquake near a known nuclear testing site in the country. The claims have not been verified independently. The alleged test followed a statement made in the previous month by Kim Jong-un, who claimed that North Korea had developed a hydrogen bomb.

In August 2015, two Korean soldiers were injured in a landmine explosion near the South Korean demilitarized zone. Claiming the landmines were set by North Koreans, the South Korean army re-initiated its propaganda program toward North Korea utilizing loudspeakers near the demilitarized zone. In retaliation, the North Korean army fired artillery rounds on the loudspeakers, resulting in the highest level of military readiness for both Koreas. High-ranking officials from North and South Korea subsequently met for discussions and entered into an agreement on August 25, 2015 intending to deflate military tensions.

From time to time, North Korea has fired short- to medium-range missiles from the coast of the Korean peninsula into the sea. Most recently in March 2015, North Korea fired seven surface-to-air missiles into waters off its east coast in apparent protest of annual joint military exercises being held by Korea and the United States.

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 December 2013, Jang Sung-taek, a relative of Kim Jong-un, who was widely speculated to be the second in command after Kim Jong-un, was executed on charges of sedition. There are reports that

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such development may cause further political and social instability in North Korea and/or adoption of more hostile policies that could engender further friction with North Korea and the rest of the world.

In April 2013, North Korea blocked South Koreans from entering the industrial complex in the border city of Kaesong. In the same month, the United States deployed nuclear-capable carriers in the South Korean air and sea space. In September 2013, however, Korea and North Korea reached an agreement and resumed operation of the Kaesong Industrial Complex, and have since made efforts to improve the business environment of the complex, including by building radio frequency identification data transfer systems and launching internet service, among others. In February 2014, the U.S. Congressional Research Service reported that Korea's approach toward the expansion and internationalization of the Kaesong Industrial Complex could conflict with U.S. legislative efforts to expand its sanctions on North Korea. On February 10, 2016, in retaliation of North Korea's recent launch of a long-range rocket, South Korea announced that it would halt its operations of the Kaesong Industrial Complex to impede North Korea's utilization of funds from the industrial complex to finance its nuclear and missile programs. In response, North Korea announced on February 11, 2016 that it would expel all South Korean employees from the industrial complex and freeze all South Korean assets in the complex.

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 could occur in the future, which would entail significant economic commitment and expenditure by Korea that may outweigh any resulting economic benefits of reunification.

There can be no assurance that the level of tension on the Korean peninsula will not escalate in the future or that the political regime in North Korea may not suddenly collapse. 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

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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.

***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.

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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 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 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.



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***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 16G. 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.

***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. All or substantially all of our directors and officers and other persons named in this annual report reside in Korea, and all or a substantial 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 effect 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 2015, and we do not expect to be a PFIC in 2016 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

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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 2016 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 consolidated total assets as of December 31, 2015 and operate the fourth largest banking business (as measured by consolidated total bank assets as of December 31, 2015) and the largest credit card business (as measured by the total credit purchase volume in 2015) 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 fourth 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 us 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 24 indirect subsidiaries offering a wide range of financial products and services, including commercial banking, corporate banking, private banking, credit card, asset 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 18.3 million active customers, which we believe is the largest customer base in Korea, through approximately 25,623 employees at approximately 1,448 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 156 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, Poland, Indonesia, Philippines and Dubai.

Our registered office and corporate headquarters are located at 20, Sejong-daero 9-gil, Jung-gu, Seoul 04513, 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

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business environment with the following general trends: (i) demographic changes due to declining birth rates and increasingly aging population, (ii) prolonged periods of low growth and low interest rates, (iii) rapid innovation in the financial industry as a result of advancements in information and communication technology (ICT) and digital finance technologies, and (iv) amplifying effects of challenges and opportunities globally. Constant changes in the global markets demand that financial service providers consistently develop new financial trends, ensure customer satisfaction by offering competitive products and services in the continued low-interest rate environment, maintain a sound infrastructure that can withstand external shocks, and enhance social responsibility and accountability.

In recognition of these trends in our business environment and in order to realize our long-term vision of becoming a world-class financial group, we have recently adopted a near term mission of (i) solidifying our position as a leading financial group in Korea and (ii) build the foundation for success in the Asian market. We aim to become Korea's number one financial brand and, at the same time, achieve meaningful growth in overseas markets by expanding into regions with high growth potential.

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

*Lead value creation through creative innovation.* By generating new ideas that drive global trends, we will strive for a synergy that increases value for both our customers and the Group. In particular, we plan to implement innovative approaches in emerging business sectors such as digital finance, retirement planning and real estate portfolio management, so that we can increase the value of our customers' assets and develop new drivers of growth for the future.

*Secure new opportunities for growth with global operations.* We will continue to expand into global high growth markets to procure a strong source of growth. To pursue meaningful advancement and move beyond a simple survey of opportunities, we plan to explore various new market entry strategies while establishing a firm presence in local markets.

*Implement integration and build 'One Shinhan' system by reforming the Group's operating system.* We will reform our operating system to (i) provide our customers with a single portal that integrates multiple business lines and (ii) continue developing integrated financial products and services. Through such strategies, we intend to enhance the group's operational efficiency and proactively accommodate customers' needs regarding total financial service packages.

*Optimize risk management preemptively in preparation for low economic growth and external shock.* In order to attain sustainable growth in an environment where risk factors are amplified and the threat of financial crises lingers, we plan to take precautionary measures to eliminate negative external factors before they arise. Moreover, we will strengthen our capacity to provide differentiated risk management and exercise our best effort to handle customer data with prudence.

*Enforce strategic cost-savings.* Due to the deterioration of structural profitability, companies in the financial sector must improve their cost structure to survive. We plan to recalibrate our current business portfolio with investments in emerging business sectors and will continue to increase operational efficiency in areas such

as business channels, processes and marketing.

*Establish a strong organizational culture based on the Shinhan Way.* We will further upgrade our policies and operating system according to our value of future-oriented compassionate finance. We aim to further invigorate the group's creative and proactive culture while nurturing a new generation of leaders based on the Shinhan Way.

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 challenge ourselves to reach a new level of excellence. Commercial banking is our principal business line and has the highest level of profitability in Korea based on its strong risk management capacity. Equipped with an extensive branch network

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and a broad customer base, our commercial banking business serves as the key sales and distribution channel for the various financial products and services we provide. We seek to solidify our brand and market position in commercial banking by offering our customers differentiated value creation strategies, strengthening our competitiveness in areas of core competencies, developing new trends in the financial sector and enhancing organizational capacity. Our plan is to further optimize risk management to address the volatility of the business environment and to continue reinforcing our commercial banking operations high profitability and central role in strengthening group-wide synergy.

*in credit card business*, our primary objectives are to further solidify our market leadership as the largest credit card service provider in Korea and to become the industry trendsetter. With such goals, we will strive to preemptively address rapid developments in the technology environment such as fintech and mobile payment services and overcome the industry's low structural growth and weakened profitability. To this end, we plan to boost our competitiveness in the mobile payment service market and increase strategic alliances based on our mobile platform. Additionally, through an overall expansion of our credit card business, we aim to diversify revenue models and become even more active in entering overseas markets. We also seek to bolster our customer service by solidifying our industry leadership in the credit card industry and improve profitability by utilizing our resources strategically.

*in securities business*, our primary objectives are to enhance our market position and to provide innovative products and services to our customers. We seek to establish a solid platform for providing leading brokerage and financial advisory services in Korea and foster a customer-centric corporate culture. We will actively incorporate collaborative platforms such as PWM (Private Wealth Management) and the Creative Finance Plaza and strive to increase our customers' rate of return by developing competitive business models and capturing promising business opportunities. Furthermore, to ensure reliable asset management for our customers, we plan to steadily update our risk management capabilities.

*in life insurance business*, our primary objective is to attain market recognition while procuring a stable source of revenue in the long term by improving the competitiveness of our life insurance program. To establish our life insurance program as the standard for the industry, we aim to broaden the reach of our operations to all business sectors and strengthen our execution capacity. Our strategy is to maximize customer value by encouraging compassionate, innovative and digital finance, augment corporate value by expanding the whole life insurance portfolio and fortifying financial solidity and increase community value by enforcing model business practices, instituting a good working environment and improving brand value.

## **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.

**ITEM 4.B. Business Overview**

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

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

international banking, which primarily focuses on management of overseas subsidiaries and branch operations and other international businesses; and

other banking, which consists of treasury business (including internal asset and liability management and other non-deposit funding activities), securities investing and trading and derivatives trading, as well as administration of the overall 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 office and corporate & investment banking business department, 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 profiles. 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 13.7%, 13.6% and 14.6% of our total deposits as of December 31, 2013, 2014 and 2015, respectively. Demand deposits paid average interest of 0.65%, 0.57% and 0.44% in 2013, 2014 and 2015, respectively.

*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 23.5%, 26.5% and 28.6% of our total deposits as of December 31, 2013, 2014 and 2015, respectively, and paid average interest of 0.96%, 0.87% and 0.70% in 2013, 2014 and 2015, respectively.

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*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 ) published by the Korean Federation of Banks. 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 61.8%, 58.7% and 54.8% of our total deposits as of December 31, 2013, 2014 and 2015, respectively, and paid average interest of 3.00%, 2.58% and 2.03% in 2013, 2014 and 2015, 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 the interest payable on the certificates of deposit. Certificates of deposit constituted approximately 1.0%, 1.1% and 2.1% of our total deposits as of December 31, 2013, 2014 and 2015, respectively and paid average interest of 2.01%, 1.32% and 1.20% in 2013, 2014 and 2015, respectively.

We also offer deposits which provide the customer with preferential rights to housing subscriptions under the Housing Law and Rules on Housing Supply (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. 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 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 ₩6,680 billion, ₩6,443 billion and ₩6,480 billion as of December 31, 2013, 2014 and 2015, respectively.

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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 ₩50 million per depositor and ₩50 million per insured under the defined contribution retirement pension 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. Our retail loans, before allowance for loan losses and deferred loan origination costs and fees and excluding credit card receivables, amounted to ₩96,018 billion as of December 31, 2015.

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 automatic teller machines ( 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. Accordingly, we believe that our retail banking services and products will become increasingly important in the coming years as the domestic banking sector further develops and becomes more complex.

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. Other retail loans also include advance loans extended on an unsecured basis to retail borrowers the use of proceeds for which is restricted to financing of home purchases prior to the completion of the construction.

As of December 31, 2015, our mortgage and home equity loans and other retail loans accounted for 57.3% and 42.7% of our total Won-denominated retail loans (excluding credit card loans), respectively.

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



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priority over our security interest (other than petty claims). The loan-to-value ratio of secured loans is updated on a monthly basis using the most recent appraisal value of the collateral. As of December 31, 2015, the loan-to-value ratio of mortgage and home equity loans of Shinhan Bank was approximately 52.86%. As of December 31, 2015, substantially all of our mortgage and home equity loans were secured by residential property.

Under the administrative instructions of the Financial Supervisory Service 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 more than ₩100 million) for the purchase of new apartments that are secured by such apartments if they are located in the greater Seoul metropolitan area, excluding some areas such as island areas; and (iii) are required to apply greater flexibility in determining the debt-to-income ratio by considering the expected earnings potential. 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>2013</b>	<b>2014</b>	<b>2015</b>
	<b>(In billions of Won, except percentages)</b>		
Retail loans <sup>(1)</sup>			
Mortgage and home-equity loans	₩ 46,908	₩ 50,652	₩ 54,983
Other retail loans	30,242	34,278	41,035
Percentage of retail loans to total gross loans	37.1%	37.9%	38.7%

*Note:*

(1) Before allowance for loan losses and deferred loan origination costs and fees and excludes credit card receivables.

The total mortgage and home equity loans amounted to ₩54,983 billion as of December 31, 2015, and as of such date, consisted of amortizing loans (whose principal is repaid by part of the installment payments) in the amount of ₩46,635 billion and non-amortizing loans in the amount of ₩8,348 billion. In addition, as of December 31, 2015, we also provided lines of credit in the aggregate outstanding amount of ₩1,030 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, which have maturities of up to 30 years for retail loans and 15 years for corporate loans 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

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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 typically 0.8% to 1.4% 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, 2015, Shinhan Bank's three-month, six-month and twelve-month base rates were approximately 1.67%, 1.69% and 1.73%, respectively. As of December 31, 2015, Shinhan Bank's fixed rates for mortgage and home equity loans with a maturity of five years and seven years were approximately 3.35% and 4.45%, respectively, and Shinhan Bank's fixed rates for other retail loans with a maturity of one year ranged from 4.31% to 14.00%, depending on the credit scores of its customers.

As of December 31, 2015, 72.5% of Shinhan Bank's total retail loans were floating rate loans and 27.5% were fixed rate loans. As of the same date, 64.3% of Shinhan Bank's retail loans with maturity of more than one year were floating rate loans and 35.7% were fixed rate loans.

The interest rate charged to customers by our banking subsidiaries is based, in part, on the cost of funds 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 eight major Korean banks (comprised of Shinhan Bank, Kookmin Bank, Woori Bank, KEB Hana Bank, Nonghyup Bank, Industrial Bank of Korea, Citibank Korea Inc. and Standard Chartered Bank Korea Limited). 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*

Historically, we have 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. Since the end of 2011, in order to preemptively respond to evolving customer needs and promote asset growth by inducing greater synergy between commercial banking and investment advisory services offered by Shinhan Investment, Shinhan Bank launched private wealth management centers which combine certain branches of Shinhan Bank with those of Shinhan Investment in same locations. Shinhan Bank's strength in private banking has been widely recognized by a number of significant industry awards in recent years, including the Best Wealth Manager in Korea and Best Private Bank in Korea awards by The Asset magazine in 2015, and the Best Private Bank in Korea at the Global Private Banking Awards 2015 co-sponsored by Professional Wealth Management and The Banker.

As of December 31, 2015, Shinhan Bank operated 27 private banking centers nationwide, including 18 in Seoul, three in the suburbs of Seoul and six in cities located in other regions in Korea. As of December 31, 2015, Shinhan Bank had approximately 6,684 private banking customers, who typically are required to have ₩500 million in deposits with

us to qualify for private banking services.

**Table of Contents****Corporate 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 loans (before allowance for loan losses and deferred loan origination costs and fees) attributable to each category of our corporate lending business as of the dates indicated.

	As of December 31,					
	2013		2014		2015	
	(In billions of Won, except percentages)					
Small- and medium-sized enterprises loans <sup>(1)</sup>	₩ 55,062	26.5%	₩ 59,889	26.8%	₩ 67,336	27.1%
Large corporate loans	31,412	15.1	33,381	14.9	33,742	13.6
Others <sup>(2)</sup>	26,698	12.8	27,538	12.3	32,796	13.2
Total corporate loans	₩ 113,172	54.4%	₩ 120,808	54.0%	₩ 133,874	53.9%

*Notes:*

(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.

(2) Includes loans to governmental agencies, loans to banks and other corporate loans.

*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, 2015, we made loans to 245,947 small- and medium-sized enterprises for an aggregate amount of ₩67,336 billion (before allowance for loan losses and deferred loan origination costs and fees).

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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 Banking*

Large corporate customers consist primarily of member companies of *chaebols* and financial institutions. Our large corporate loans amounted to ₩33,742 billion (before allowance for loan losses and deferred loan origination costs and fees) as of December 31, 2015. 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, 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, pooling, ERP interface service, host-to-host banking solutions, SWIFT SCORE service and global cash and liquidity management service. In addition, Shinhan Bank provides customers with integrated and advanced access to its

financial services through its Inside Bank 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.



**Table of Contents***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 capital purposes. Facilities loans are provided to finance the purchase of equipment and construction of manufacturing plants. As of December 31, 2015, working capital loans and facilities loans amounted to ₩57,093 billion and ₩39,803 billion, respectively, representing 58.9% and 41.1% of our 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 10 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, 2015, secured loans and guaranteed loans (including loans secured by guaranty certificates issued by credit guarantee insurance funds) accounted for 58.7% and 10.3%, respectively, of our Won-denominated loans to small- and medium-sized enterprises. As of December 31, 2015, 47.1% of the corporate loans were secured by real estate.

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, 2015, 51.9% 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, 2015, 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 1.67% for three months, 1.69% for six months, 1.73% for one year, 1.78% for two years, 1.84% for three years and 2.02% for five years. As of the same date, Shinhan Bank's reference rate was 5.75%. 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 0.35% of all loans (excluding certain loans such as facility loans) made by them.

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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.

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.

### ***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.

### ***Other Banking Services***

Other banking businesses carried on by Shinhan Bank include treasury business (including internal asset and liability management and other non-deposit funding activities), trading of, and investment in, debt securities and, to a lesser extent, equity securities for its own accounts, derivative trading activities, as well as managing back-office functions.

### ***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;

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

equity and equity-linked options;

foreign currency forwards, options and swaps;

commodity forwards, swaps and options;

credit derivatives; and

KOSPI 200 indexed equity options.

Shinhan Bank's outstanding derivatives commitments in terms of notional amount were ~~₩122,842 billion, ₩106,498 billion and ₩132,785 billion~~ in 2013, 2014 and 2015, respectively. Such derivative operations generally focus on addressing the needs of Shinhan Bank's corporate clients to enter into derivatives 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.

## ***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, 2013, 2014 and 2015, Shinhan Bank had total trust assets of ₩26,342 billion, ₩30,986 billion, and ₩37,304 billion respectively, comprised principally of securities investments of ₩5,195 billion, ₩6,239 billion, and ₩7,688 billion respectively; real property investments of ₩4,723 billion, ₩5,913 billion, and ₩7,576 billion respectively; and loans with an aggregate principal amount of ₩466 billion, ₩434 billion, and ₩454 billion respectively. Securities investments consisted of corporate bonds, government-related bonds and other securities, primarily commercial paper. As of December 31, 2013, 2014 and 2015, debt securities

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accounted for 18.3%, 18.9% and 19.2%, respectively, and equity securities constituted 1.4%, 1.3% and 1.4%, 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, 2013, 2014 and 2015, approximately 54.5%, 57.9% and 53.3%, 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 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 ~~₩16,830 billion~~, ~~₩19,591 billion~~ and ~~₩24,093 billion~~ as of December 31, 2013, 2014 and 2015, respectively.

Shinhan Bank offers variable rate trust products through its retail branch network. As of December 31, 2013, 2014 and 2015, Shinhan Bank's variable rate trust accounts amounted to ~~₩13,531 billion~~, ~~₩16,121 billion~~ and ~~₩20,443 billion~~, respectively, of which principal guaranteed variable rate trust accounts amounted to ~~₩3,298 billion~~, ~~₩3,469 billion~~ and ~~₩3,649 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 offers 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, 2013, 2014 and 2015, 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. The minimum monthly payment for holders of credit cards issued before December 30, 2014 is the lesser of (x) 5% to 20% of the amount outstanding (depending on the cardholder's credit) or (y) ₩30,000. The minimum monthly payment for holders of credit cards issued on or after December 30, 2014 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 5.44% to 24.94%.



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*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, in the case of credit cards issued before December 30, 2014, on a revolving basis. Currently, the lump-sum cash advances generally accrue interest at the effective annual rates of approximately 6.14% to 26.64% 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 generally ranging from two months to 24 months, and for certain limited types of cards, up to 36 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 is 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 interest amounts in full at maturity, or (iii) making interest-only payments during the initial grace period of either three months or six months and repaying the principal and interest amounts on a monthly installment basis over the remaining period of typically two to 30 months. Currently, the outstanding card loan balances generally accrue interest at the effective annual rates of approximately 6.3% to 24.7%. 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 and most of the affinity and co-branded 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. Certain government affinity cards have no annual membership fee. 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 27.9% per annum.

Merchant discount fees, which are processing fees Shinhan Card charges to merchants, can be up to the regulatory limit of 2.5% of the purchased amount depending on the merchant used, with the average charge for credit cards being 1.85% in 2015. For small- and medium-sized merchants, the applicable regulations impose reduced fee rates of 0.8% (in the case of merchants with annual sales of ₩200 million or less) and 1.3% (in the case of merchants with annual sales of more than ₩200 million and up to ₩300 million), respectively, of the purchased amount.

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

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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 0.50% and 2.50%, depending on the type of business, which is lower than the corresponding fee charged for credit card use.

### *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, prizes 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.

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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.

	<b>As of December 31,</b>		
	<b>2013</b>	<b>2014</b>	<b>2015</b>
	<b>(In thousands, except percentages)</b>		
<b>Shinhan Card:</b>			
Number of credit card holders <sup>(1)</sup>	13,493	12,578	12,163
Personal accounts	13,385	12,468	12,052
Corporate accounts	108	110	111
Active ratio <sup>(2)</sup>	93.7%	97.1%	97.9%
Number of merchants	2,392	2,491	2,513

*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 installment finance operations accounted for 2.0% of Shinhan Card's total operating revenue in 2015. 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 2015.

### ***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

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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, 2015, according to internal data, Shinhan Investment's annual market share of Korean equity brokerage market was 5.92% (consisting of 2.83% in the retail segment, 0.58% in the institutional segment and 2.51% in the international segment) in terms of total brokerage volume, ranking third among securities firms in Korea. As of the same date, according to internal data, Shinhan Investment held the second largest annual market share in the options brokerage segment and the third largest annual market share in the KOSPI 200 futures segment of 5.90% and 5.69%, 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 institutional financial products. These services are currently supported by a team of approximately 82 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 three overseas service centers in Hong Kong, New York and Vietnam. In July 2015, we acquired a 100% stake in Nam An Securities, a Vietnamese securities services firm that provides investment banking and asset management services.



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**Table of Contents*****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, 2013, 2014 and 2015, Shinhan Life Insurance had total assets of ₩19,379 billion, ₩21,940 billion and ₩24,545 billion and net profits of ₩76 billion, ₩81 billion and ₩100 billion, respectively. In 2016, 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 managers in Korea in terms of assets under management as of December 31, 2015, 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 significant benefits from BNP Paribas' global network of investment professionals and expertise in the asset management industry. As of December 31, 2015, Shinhan BNP Paribas Asset Management had assets under management amounting to approximately ₩37,808 billion. To a limited extent, Shinhan Investment also provides asset management services for discretionary accounts, see Securities Brokerage Services.

In 2016, we expect the activity level in the asset management industry, including fund formation activities, to remain similar to 2015 due to uncertainties surrounding the domestic and international economy. The sustained low interest rate environment and continuing sluggishness in the general economy has led to lower expected returns for financial investments, and we therefore do not expect a significant increase in investments in domestic equity/fixed income funds and other traditional investment products. However, we expect an increased interest in globally diversified investment portfolios due to an increasing demand for broader asset allocation amidst continuing uncertainty in the financial markets.

***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.

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### *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, 2015.

### *Savings Banking*

Through Shinhan Savings Bank, 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. 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 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.

**Table of Contents****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, 2015.

<i>Distribution Channels in Korea</i> <sup>(1)</sup>	Shinhan Bank	Jeju Bank	Shinhan Card	Shinhan Investment	Shinhan Life Insurance	Total
Seoul metropolitan	371	2	6	54	50	483
Gyeonggi province	200		4	18	33	255
Six major cities:	169	1	7	22	52	251
Incheon	56		1	3	15	75
Busan	39	1	2	6	14	62
Gwangju	13		1	3	8	25
Daegu	28		1	4	6	39
Ulsan	13		1	3	2	19
Daejeon	20		1	3	7	31
Sub-total	740	3	17	94	135	989
Others	159	35	11	14	52	271
Total	899	38	28	108	187	1,260

*Note:*

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

***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, 2015, Shinhan Bank's branch network in Korea comprised of 900 service centers, consisting of our headquarters, 668 retail banking service centers, nine corporate banking service centers primarily designed to serve large corporate customers and 222 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. An extensive retail branch network has traditionally played an important role as the main platform for a wide range of banking transactions. However, a growing number of customers are turning to other service channels to meet their banking needs, such as Internet banking, mobile banking and other forms of non-face-to-face platforms. In response to such changes, Shinhan Bank has recently been focused on reorganizing its retail branch network, including shifting, merger or closure of certain branches that are considered redundant.

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

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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. In December 2015, Shinhan Bank introduced a new generation of automated self-service machines called digital kiosks, which are currently being test-run at 17 branches in the Seoul metropolitan area. These digital kiosks feature biometric authentication technology and can perform a wide range of services that are unavailable through traditional ATMs, such as opening new accounts, issuance of debit and check cards, foreign currency exchange and overseas remittance of foreign currency. As of December 31, 2015, Shinhan Bank had 6,816 ATMs, three cash dispensers and 24 digital kiosks. 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 2015, automated banking machine transactions accounted for a substantial portion 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 of December 31, 2015, Shinhan Bank had approximately 15,321,000 subscribers to its Internet banking services and approximately 10,027,000 users of its smart banking apps, representing an increase of 7.1% and 16.5%, respectively, compared to December 31, 2014. Shinhan Bank continues to experience a rise in the number of online and mobile banking users. Shinhan Bank began offering online and mobile banking initially with a view to saving costs rather than increasing revenues, but is currently exploring ways to leverage the possibility of increase revenues through online and mobile banking given that these services offer customers with easier and more convenient access to banking services without limitations of time and space as well as offer tailored and customized service to each customer. In December 2015, Shinhan Bank launched Sunny Bank, a new mobile platform that is more user friendly and easier to access than the previous platform. Sunny Bank utilizes non-face-to-face identity authentication technology, which allows users to open new bank accounts, apply for loans and use other services through the Sunny Bank mobile application without having to visit a physical bank branch.

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

The table below sets forth Shinhan Bank's overseas banking subsidiaries and branches as of December 31, 2015.

<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>	Frankfurt, Germany	1994
Shinhan Bank America	New York, U.S.A.	2003
Shinhan Bank (China) Limited	Beijing, China	2008
Shinhan Khmer Bank PLC	Phnom Penh, Cambodia	2007
Shinhan Bank Kazakhstan Limited	Almaty, 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
PT Bank Metro Express	Jakarta, Indonesia	2015
PT Centratama Nasional Bank	Surabaya, Indonesia	2015

<b>Business Unit</b>	<b>Location</b>	<b>Year Established or Acquired</b>
<i>Branches</i>		
Banco Shinhan de Mexico <sup>(4)</sup>	Mexico City, Mexico	2015
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
Manila	Philippines	2015
Dubai	United Arab Emirates	2015
<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 provided banking services in Vietnam through a branch since 1995.
- (4) Banco Shinhan de Mexico obtained a preliminary license in August 2015. As of the date of this annual report, Banco Shinhan de Mexico's application for full business license is pending.

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

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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 and in 2011 merged two of our Vietnam banking subsidiaries in order to enhance our presence and enable greater flexibility in its service offerings in these markets. We plan to maintain our focus on organic growth, while we may selectively pursue acquisitions in markets where it is difficult to obtain local banking licenses through greenfield entry. In furtherance of this objective, Shinhan Bank acquired a 97.8% stake in Bank Metro Express and a 75% stake in Centratama Nasional Bank, two commercial banks in Indonesia, in November and December 2015, respectively. We are currently contemplating the combination of the two banks with the goal of facilitating its penetration into the emerging Indonesian market. Shinhan Bank also opened additional branches in the Philippines and United Arab Emirates in the second half of 2015 and established a local subsidiary in Mexico in October 2015, and is planning to open an additional branch in Australia in 2016. We plan to continue our efforts to expand our overseas banking service network and global operations.

***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 899 branches as of December 31, 2015 of Shinhan Bank and 28 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 2015, the number of new cardholders acquired through our banking distribution network accounted for approximately 23% 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 2015, and the number of new cardholders acquired through sales agents accounted for approximately 52% of the total number of Shinhan Card's new cardholders in 2015. As of December 31, 2015, Shinhan Card had 2,888 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 generally tied to the transaction volume of the customers introduced by them, and we believe this system helps to 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, obtained its business license in the first half of 2015 and commenced its operations in July 2015 including installment financing and credit loans. It is expected to offer additional services such as financing leases beginning in 2017.

In December 2015, Shinhan Card acquired a majority stake in PT Swadharma Indotama Finance, a multi finance company in Indonesia, and changed its legal name to PT Shinhan Indo Finance. PT Shinhan Indo Finance engages in retail operations including installment financing and financial leases and is expected to obtain its credit card business

license by the end of 2016 to offer credit card services.

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

Our securities brokerage services are conducted principally through Shinhan Investment. As of December 31, 2015, Shinhan Investment had 108 service centers nationwide, and three overseas subsidiaries based in Hong Kong, New York and Vietnam to service our corporate customers.

Approximately 50% 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, 2015, Shinhan Life Insurance had 187 branches and 11 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 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 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. 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.

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.

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 bolster their

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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. We also established in April 2015 a new credit evaluation system with enhanced precision in assessing the creditworthiness of our corporate customers, which has enabled us to manage our credit risk more effectively. Furthermore, we have expanded, and will continue to expand, our 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.

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.

**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, 2015, Korea had six 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 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

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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 potential 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.

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 enterprises (which are subject to revision every three years) 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. Most recently, in November 2015, the Government announced a further reduction in the merchant fees chargeable to small- and medium-sized enterprises with effect from January 31, 2016, and this is expected to place downward pressure on Shinhan Card's results of operations for 2016 and beyond. 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 and the Government's privatization efforts may also add competition in the markets in which we and our subsidiaries conduct business. A number of significant mergers and acquisitions in the industry have taken place in Korea over the past decade, including the acquisition of Hanmi Bank by an affiliate of Citibank in 2004, Standard Chartered Bank's acquisition of Korea First Bank in 2005, Chohung Bank's merger with Shinhan Bank in 2006, and Hana Financial Group's acquisition of Korea Exchange Bank in 2012 and the resulting merger of Hana Bank and Korea Exchange Bank in September 2015. Moreover, in 2014, pursuant to the implementation of the Government's privatization plan with respect to Woori Finance Holdings (now merged into



Woori Bank) and its former subsidiaries, Woori Financial, Woori Asset

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Management and Woori F&I were acquired by KB Financial Group, Kiwoom Securities and Daishin Securities, respectively, and Woori Investment & Securities, Woori Aviva Life Insurance and Woori FG Savings Bank were acquired by NongHyup Financial Group. In 2015, the Government decided to sell a 30% to 40% interest in Woori Bank to multiple investors in separate blocks ranging from 4% to 10% each. Although such attempts have stalled, most recently in January 2016 when discussions with three Saudi Arabian sovereign funds broke off, the Government is expected to continue efforts to sell minority stakes of Woori Bank. In addition, in October 2014, the Government's ownership interest in the holding companies of Kwangju Bank and Kyongnam Bank were acquired by JB Financial Group and BS Financial Group (now BNK Financial Group), respectively. In the securities brokerage sector, Mirae Asset agreed in January 2016 to acquire KDB Daewoo Securities, which, if successfully consummated, will create the largest brokerage company in Korea by assets. 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. We expect that such consolidation and other structural changes in the financial industry will continue. Other financial institutions may seek to acquire or merge with other entities, and the financial institutions resulting from such consolidation may, by virtue of their increased size and business scope, provide greater competition for us. Increased competition and continuing consolidation may lead to decreased margins, resulting in a material adverse impact on our future profitability.

Regulatory reforms and the general modernization of business practices in Korea have also led to increased competition among financial institutions in Korea. From early 2009, financial investment companies with a dealing license and/or brokerage license are allowed to provide secondary services in connection with securities investments such as settlement and remittance services relating to customer deposits. In addition, in the second half of 2015, the Financial Services Commission began to take steps to adopt the account switch service, which allows customers to manage or switch their automatic payment transfer accounts in a more convenient way. For example, the Financial Services Commission introduced the integrated automatic payment transfer management system, which enables customers to change the bank account through which automatic payment transfers are made by following simple steps online or visiting a bank branch, with the banks being responsible for implementing the change should the customer decide to switch banks. Prior to the introduction of the account switch service, customers had the onus of making arrangements with each of the involved banks as well as the payment recipient to make the change. Under the new system, it is expected that customers will find it easier to switch from one bank to another. Currently, the service only applies to limited types of payment transfers, but the Financial Services Commission plans to expand the service with respect to all types of payment transfers by June 2016. Furthermore, effective March 2016, the Financial Services Commission introduced the ISA system, as part of its efforts to lower the regulatory barrier between the banking and securities sectors. The ISA is an integrated account that enables account holders to manage a number of different financial products, including cash deposits, funds and securities investment accounts, from a single account, the income from which will be eligible for tax benefits. Since this new system does not allow an individual to hold multiple ISA accounts, competition among banks and securities firms to retain existing customers and attract new customers is expected to intensify. As a result, Shinhan Bank may face difficulties in increasing or retaining its deposits, which in turn may result in an increase in its cost of funding and a decrease in its settlement and remittance service fee revenue. As the reform of the financial sector continues, competition may become more intense among existing banks, insurance companies, securities companies and other financial organizations, and may lead to significant changes in the current Korean financial market.

Furthermore, as the Korean economy further develops and new business opportunities arise, more competitors may enter the financial services industry. For example, as online service providers and technology companies with large-scale user networks, such as Kakao Corp., NAVER and Samsung Electronics, recently 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 and mobile payment service providers. Also, widespread consumer acceptance of mobile phone payment services in lieu of credit card services could add to

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competitive threat to the existing credit card service providers, including our credit card subsidiary. In addition, the Government recently announced its plans to allow Internet-only banks to operate in Korea. As of the date hereof, two business consortiums, Kakao consortium and KT consortium, have been granted preliminary permission by the Government to operate Internet-only banks. These consortiums are expected to apply for final permission during the second half of 2016 and commence operations within six months of the final permission being granted by the Government. Internet-only banks may have advantages over traditional banks as the former can pass savings in labor and overhead costs to their customers by offering higher interest rates on deposit accounts, lower loan costs and reduced service fees. Accordingly, commercial banks will likely face 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.

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, whose minimum requirements were phased in sequentially from December 1, 2013 through full implementation by January 1, 2015, 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 is currently implementing the Basel III requirements relating to liquidity coverage ratio and capital conservation buffer, each of which will be fully phased in by January 1, 2019. Furthermore, the Financial Services Commission announced that it would implement the Basel III requirements relating to countercyclical capital buffer, which was initially set at 0% on March 30, 2016 but may be subject to change upon quarterly review by the Financial Services Commission. However, there is no assurance that these measures will have the effect of curbing 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, despite our efforts to adapt to the changing macroeconomic environment and comply with new regulations, 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 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, 2015, our total gross loan portfolio was ₩248,429 billion, which represented an increase of 11.0% from ₩223,879 billion at December 31, 2014. The increase in our portfolio primarily reflects a 10.82% increase in corporate loans and a 13.1% 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.

	2011	2012	As of December 31, 2013			2014	2015
			(In billions of Won)				
<b>Corporate</b>							
Corporate loans <sup>(1)</sup>	₩ 98,598	₩ 101,162	₩ 102,823	₩ 112,145	₩ 125,155		
Public and other <sup>(2)</sup>	4,930	3,107	2,525	2,135	2,191		
Loans to banks <sup>(3)</sup>	2,557	4,557	6,103	4,684	4,653		
Lease financing	1,639	1,699	1,721	1,844	1,875		
<b>Total Corporate</b>	<b>107,724</b>	<b>110,525</b>	<b>113,172</b>	<b>120,808</b>	<b>133,874</b>		
<b>Retail</b>							
Mortgages and home equity	44,399	46,130	46,908	50,652	54,983		
Other retail <sup>(4)</sup>	25,052	28,407	30,242	34,278	41,035		
<b>Total Retail</b>	<b>69,451</b>	<b>74,537</b>	<b>77,150</b>	<b>84,930</b>	<b>96,018</b>		
Credit cards	17,880	17,854	17,665	18,141	18,537		
<b>Total loans<sup>(5)</sup></b>	<b>₩ 195,055</b>	<b>₩ 202,916</b>	<b>₩ 207,987</b>	<b>₩ 223,879</b>	<b>₩ 248,429</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, 2011, 2012, 2013, 2014 and 2015, approximately 88.8%, 89.6%, 90.0%, 89.1% and 89.4% 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 Individual Borrower*

As of December 31, 2015, our 20 largest exposures, consisting of loans, securities and guarantees and acceptances, totaled ₩45,520 billion. The following table sets forth our total exposures to these top 20 borrowers as of December 31, 2015.

	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)						
The Bank of Korea	₩ 3,430	₩	₩ 6,858	₩	₩	₩ 10,288	₩
Ministry of Strategy and Finance			7,970			7,970	
Korea Development Bank	16	55	5,382			5,453	
Korea Housing Finance Corporation.			4,963			4,963	
Industrial Bank of Korea.	568		1,390			1,958	
Korea Deposit Insurance Corporation.			1,914			1,914	
Hyundai Heavy Industries Co., Ltd.	47	33	1	1,261		1,342	
Samsung Electronics Co., Ltd.		1,134	15			1,149	
Samsung Heavy Industries Co., Ltd	150	4	10	901		1,065	
Kookmin Bank.	475		562			1,037	
Korea Securities Finance Corporation.	125		869			994	
Woori Card Co., Ltd	199	59	731	1		990	
Korea Land & Housing Corporation			949			949	
Nonghyup Bank.	348	12	547	6		913	
Hyundai Steel Co., Ltd	675	43	41	41		800	
Export-Import Bank of Korea			790	6		796	
Hotel Lotte Co., Ltd.		398	149	241		788	
Hyundai Samho Heavy Industries Co., Ltd	2	56		713		771	
KEB Hana Bank	137	32	553			722	
LG Electronics Inc.	48	55	77	478		658	

Total	₩ 6,220	₩ 1,881	₩ 33,771	₩ 3,648	₩	₩ 45,520	₩
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**Table of Contents***Exposure to Main Debtor Groups*

As of December 31, 2015, our total exposure to the main debtor groups as identified by the Governor of the Financial Supervisory Service amounted to 31,835 billion. The main debtor groups are largely comprised of *chaebols*. The following table shows, as of December 31, 2015, 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)
Samsung	₩ 424	₩ 1,857	₩ 666	₩ 1,523	₩	₩ 4,470	₩
Hyundai Motors	1,437	1,407	1,161	278		4,283	
Lotte	410	1,040	1,293	484	2	3,229	
Hyundai Heavy Industries	206	144	31	2,576		2,957	1
SK	469	377	901	1,133		2,880	
LG	463	464	306	757		1,990	
LS	193	366	171	740		1,470	
Hanwha	625	238	215	231		1,309	
GS	380	97	342	154		973	
Hyosung	238	490	33	150		911	
<b>Total</b>	<b>₩4,845</b>	<b>₩ 6,480</b>	<b>₩ 5,119</b>	<b>₩ 8,026</b>	<b>₩ 2</b>	<b>₩ 24,472</b>	<b>₩ 1</b>

*Loan Concentration by Industry*

The following table shows the aggregate balance of our corporate loans by industry concentration as of December 31, 2015.

Industry	Aggregate Loan Balance (In billions of Won)	Percentage of Total Corporate Loan Balance (Percentages)
Manufacturing	₩ 39,569	29.6%
Real estate, leasing and service	19,236	14.4
Retail and wholesale	16,250	12.1
Finance and insurance	10,459	7.8

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Hotel and leisure		5,904	4.4
Transportation, storage and communication		4,005	3.0
Construction		2,820	2.1
Other service <sup>(1)</sup>		12,486	9.3
Other <sup>(2)</sup>		23,145	17.3
Total	₩	133,874	100.0%

*Notes:*

- (1) Includes other service industries such as publication, media and education.
- (2) Includes other industries such as agriculture, forestry, mining, electricity and gas.

**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, 2015. The amounts below are before deduction of attributable loan loss reserves. In the case of installment payment loans, maturities have been adjusted to take into account the timing of installment payments.

	<b>As of December 31, 2015</b>			
	<b>1 Year or Less</b>	<b>Over 1 Year but Not More Than 5 Years</b>	<b>Over 5 Years<sup>(1)</sup></b>	<b>Total</b>
	<b>(In billions of Won)</b>			
<b>Corporate:</b>				
Corporate loans	₩ 88,295	₩ 31,501	₩ 5,359	₩ 125,155
Public and other	1,556	511	124	2,191
Loans to banks	4,006	480	167	4,653
Lease financing	696	1,177	2	1,875
<b>Total corporate</b>	<b>₩ 94,553</b>	<b>₩ 33,669</b>	<b>₩ 5,652</b>	<b>₩ 133,874</b>
<b>Retail:</b>				
Mortgage and home equity	₩ 8,026	₩ 12,283	₩ 34,674	₩ 54,983
Other retail	27,559	10,990	2,486	41,035
<b>Total retail</b>	<b>₩ 35,585</b>	<b>₩ 23,273</b>	<b>₩ 37,160</b>	<b>₩ 96,018</b>
<b>Credit cards</b>	<b>₩ 16,465</b>	<b>₩ 1,848</b>	<b>₩ 224</b>	<b>₩ 18,537</b>
<b>Total loans</b>	<b>₩ 146,603</b>	<b>₩ 58,790</b>	<b>₩ 43,036</b>	<b>₩ 248,429</b>

*Note:*

(1) Includes overdue loans.

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 of our loans in terms of interest rate sensitivity as of December 31, 2015.

	<b>As of December 31, 2015</b>		<b>Total</b>
	<b>Due Within 1 Year<sup>(1)</sup></b>	<b>Due After 1 Year</b>	
	<b>(In billions of Won)</b>		
Fixed rate loans <sup>(1)</sup>	₩ 70,135	₩ 43,434	₩ 113,569
Variable rate loans <sup>(2)</sup>	76,468	58,392	134,860
<b>Total loans</b>	<b>₩ 146,603</b>	<b>₩ 101,826</b>	<b>₩ 248,429</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.

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For additional information regarding our management of interest rate risk, see Risk Management.

***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 2011, 2012, 2013, 2014 and 2015 we would have recorded gross interest income of ₩131 billion, ₩163 billion, ₩119 billion, ₩113 billion and ₩79 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 2011, 2012, 2013, 2014 and 2015 were ₩66 billion, ₩70 billion, ₩58 billion, ₩53 billion and ₩39 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.

	<b>As of December 31,</b>				
	<b>2011</b>	<b>2012</b>	<b>2013</b>	<b>2014</b>	<b>2015</b>
	<b>(In billions of Won)</b>				
<b>Loans accounted for on a nonaccrual basis<sup>(1)</sup></b>					
Corporate	₩ 1,621	₩ 1,642	₩ 1,660	₩ 1,358	₩ 1,235
Retail	239	416	217	233	228
Credit cards	152	215	108	152	93
<b>Sub-total</b>	<b>2,012</b>	<b>2,273</b>	<b>1,985</b>	<b>1,743</b>	<b>1,556</b>
<b>Accruing loans which are contractually past due one day or more as to principal or interest</b>					
Corporate	224	245	194	183	176
Retail	482	354	436	374	316
Credit cards	576	633	524	466	399
<b>Sub-total</b>	<b>1,282</b>	<b>1,232</b>	<b>1,154</b>	<b>1,023</b>	<b>891</b>
<b>Total</b>	<b>₩ 3,294</b>	<b>₩ 3,505</b>	<b>₩ 3,139</b>	<b>₩ 2,766</b>	<b>₩ 2,447</b>

*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.

	2011	As of December 31, (In billions of Won)			
		2012	2013	2014	2015
Loans classified as troubled debt restructurings (excluding nonaccrual and past due loans)	₩ 75	₩ 173	₩ 71	₩ 173	₩ 244
Loans classified as troubled debt restructurings (including nonaccrual and past due loans)	₩ 1,009	₩ 868	₩ 756	₩ 635	₩ 714

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.

	2011	2012	2013	2014	2015
	(In billions of Won)				
Interest income under the original contractual terms of the restructured loans <sup>(1)</sup>	₩ 42	₩ 74	₩ 68	₩ 21	₩ 22
Interest income under the restructured contractual terms of the restructured loans <sup>(1)</sup>	₩ 14	₩ 20	₩ 15	₩ 12	₩ 6

*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, 2011, 2012, 2013, 2014 and 2015 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.

		As of December 31,				
2011	2012	2013	2014	2015		
Outstanding	Outstanding	Outstanding	Outstanding	Outstanding	Outstanding	
Balance	Allowance	Balance	Allowance	Balance	Allowance	
(In billions of Won)						

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Workout	₩ 752	₩ 351	₩ 683	₩ 276	₩ 571	₩ 266	₩ 476	₩ 471	₩ 506	₩ 215
Recovery Proceedings	250	38	185	20	185	75	159	144	208	63
Others <sup>(1)</sup>	7	5								
Total	₩ 1,009	₩ 394	₩ 868	₩ 296	₩ 756	₩ 341	₩ 635	₩ 615	₩ 714	₩ 278

*Note:*

(1) 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).

The following table presents the outstanding balance and specific allowance for loan losses as of December 31, 2011, 2012, 2013, 2014 and 2015 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



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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,									
	2011		2012		2013		2014		2015	
	Outstanding	Allowance	Outstanding	Allowance	Outstanding	Allowance	Outstanding	Allowance	Outstanding	Allowance
	(In billions of Won)									
Retail loans subject to credit rehabilitation programs <sup>(1)</sup> :	₩ 68	₩ 54	₩ 60	₩ 46	₩ 41	₩ 30	₩ 45	₩ 27	₩ 61	₩ 40

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,				
	2011	2012	2013	2014	2015
	(In billions of Won)				
Impaired and nonaccrual restructured loans	₩ 934	₩ 695	₩ 685	₩ 462	₩ 470
Total charge-off of restructured loans	₩ 259	₩ 263	₩ 153	₩ 55	₩ 259
Charge-off as part of debt-to-equity conversion	₩ 46	₩ 84	₩ 29	₩ 32	₩ 51

**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, 2015, 0.3% of our total loans, or ₩714 billion (of which ₩470 billion was classified as nonaccrual and ₩244 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 old Corporate Restructuring Promotion Act, which expired on December 31, 2015, all creditors that are financial institutions were required to participate in a creditors' committee. The old Corporate Restructuring Promotion Act was mandatorily applicable to a wide range of financial institutions in Korea, including 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 was required for such borrower's restructuring plan, including debt restructuring and provision of additional funds, which plan would be 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. In the event that the creditors' committee and the dissenting financial institution creditor fail to come to an agreement, the act provided that a mediation committee consisting of seven experts be formed to resolve the matter.

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The above-mentioned old Corporate Restructuring Promotion Act expired on December 31, 2015, and a new Corporate Restructuring Promotion Act, which modified and expanded the old act in several respects, was passed in the National Assembly of Korea on March 3, 2016. The new Corporate Restructuring Promotion Act has extended the definition of borrower subject to the act from any enterprise whose total amount of credit granted from financial institution creditors is at least ₩50 billion to any enterprise that is a corporation under the Korean Commercial Code or any other entity performing commercial activities. The new Corporate Restructuring Promotion Act has also extended the definition of creditor who may participate in a creditors committee from financial institution creditors to all creditors who have claims to the borrower through granting of credit. Under the new act, the creditors that constitute the creditors committee shall be determined at the committee's initial assembly based on the approval of creditors that hold 75% or more of the total debt outstanding held by creditors notified of such initial assembly. Although creditors that are not financial institutions or possess less than 1% of the total amount of claims to the borrower may not be notified of the assembly of the creditors committee, if such creditors wish to participate, they shall not be excluded from the committee. Also, resolutions of the creditors committee shall be adopted by the approval of creditors holding 75% or more of the total debt outstanding to the creditors of the committee. However, if a single creditor holds 75% or more of the total debt outstanding to the creditors of the committee, resolutions shall be adopted by a vote of 40% or more of the total number of creditors of the committee, including such single creditor. The new Corporate Restructuring Promotion Act is set to expire on June 30, 2018.

The total loan amount currently undergoing workout as of December 31, 2015 was ₩506 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, 2015, the total loan amount subject to recovery proceedings was ₩208 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.



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*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.

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.

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 2016, 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) borrowings from at least two financial institutions not exceeding ₩1.5 billion in the aggregate (₩1.0 billion in secured borrowings and ₩0.5 billion in unsecured borrowings); (ii) payment default of more than 30 days but less than 90 days including payment default of not exceeding 30 days in case where the borrower's annual income is not exceeding ₩40 million and there was payment default of not less than 30 days, within one year prior to the application for the pre-workout program. 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 unsecured loans may be extended by up to 10 years and maturity of secured loans may be extended by up to 20 years with a grace period not exceeding three 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 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.

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*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 every six months, for a period not to exceed six months, upon the borrower's application. The deferral period is not counted toward the repayment period, and interest accrues at 3% per annum during the deferral period.

In 2015, the aggregate amount of our retail credit (including credit card receivables) provided by Shinhan Bank which became subject to the pre-working program was ₩54 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 Troubled Debt 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.

The following table presents a breakdown of the gross amount of loans under restructuring as of December 31, 2011, 2012, 2013, 2014 and 2015 by our loan modification programs, as further categorized according to the loan category and performing versus non-performing status at each fiscal year end.

Modification Programs	December 31, 2011		
	Non-Performing	Performing	Total
	(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>

Modification Programs	December 31, 2012		
	Non-Performing	Performing	Total
	(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			

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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>

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Modification Programs	December 31, 2013		
	Non-Performing	Performing	Total
	(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	December 31, 2014		
	Non-Performing	Performing	Total
	(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>

Modification Programs	December 31, 2015		
	Non-Performing	Performing	Total
	(In billions of Won)		
Extension of due date for principal and interest	₩	₩ 87	₩ 87
Reduction of interest rate	119	368	487
Forgiveness of principal			
Equity conversion			
Additional lending <sup>(1)</sup>	4	19	23
Others <sup>(2)</sup>	87	30	117
<b>Total</b>	<b>₩ 210</b>	<b>₩ 504</b>	<b>₩ 714</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 date 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 2015, our loans restructured into equity securities amounted to ₩51 billion, of which ₩29 billion was subsequently treated as charge-off and ₩22 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.

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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 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, 2015, we had ₩771 billion of potential problem loans.

### ***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.

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.



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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 include the use of non-face-to-face channels such as texting and calling and 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-month 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)									
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
2015	245,997	99.02	1,098	0.44	781	0.31	553	0.22	248,429

**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,				
	2011	2012	2013	2014	2015
(In billions of Won, except percentages)					
Total non-performing loans	₩ 1,416	₩ 1,695	₩ 1,197	₩ 1,286	₩ 1,333
As a percentage of total loans	0.73%	0.84%	0.58%	0.57%	0.54%

**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.

	As of December 31,											
	2011			2012			2013			2014		
	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)												
08	₩ 739	0.75%	₩ 101,162	₩ 769	0.76%	₩ 102,823	₩ 529	0.51%	₩ 112,145	₩ 551	0.49%	₩ 125,155
30	8	0.16	3,107	9	0.29	2,525			2,135			2,191
57			4,557			6,103			4,684			4,653
39	5	0.31	1,699	8	0.47	1,721	11	0.64	1,844	15	0.81	1,875
24	752	0.70	110,525	786	0.71	113,172	540	0.48	120,808	566	0.47	133,874
09	55	0.12	46,130	60	0.13	46,908	41	0.09	50,652	56	0.11	54,983
52	164	0.65	28,407	315	1.11	30,242	174	0.58	34,278	173	0.50	41,035
51	219	0.31	74,537	375	0.50	77,150	215	0.28	84,930	229	0.27	96,018
30	445	2.49	17,854	534	2.99	17,665	442	2.50	18,141	491	2.71	18,537
55	₩ 1,416	0.73%	₩ 202,916	₩ 1,695	0.84%	₩ 207,987	₩ 1,197	0.58%	₩ 223,879	₩ 1,286	0.57%	₩ 248,429

Note:

(1)



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, 2015.

Industry	Aggregate Non-Performing Corporate Loan Balance (In billions of Won)	Percentage of Total Non-Performing Corporate Loan Balance (Percentages)
Construction	₩ 179	26.3%
Manufacturing	170	25.0
Real estate, leasing and service	99	14.6
Retail and wholesale	66	9.7
Finance and insurance	45	6.6
Hotel and leisure	25	3.7
Transportation, storage and communication	21	3.1
Other service <sup>(1)</sup>	24	3.5
Other <sup>(2)</sup>	51	7.5
Total	₩ 680	100.0%

*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, 2015, our 20 largest non-performing loans accounted 29.7% of our total non-performing loan portfolio. The following table shows, at the date indicated, certain information regarding our 20 largest non-performing loans.

			As of December 31, 2015		
Industry			Gross Principal Outstanding	Allowance for Loan Losses	
			(In billions of Won)		
1	Borrower A	Construction	₩ 88	₩	4

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2	Borrower B	Construction	43	42
3	Borrower C	Finance and insurance	36	7
4	Borrower D	Real estate, leasing and service	30	22
5	Borrower E	Manufacturing	29	3
6	Borrower F	Real estate, leasing and service	23	
7	Borrower G	Construction	18	3
8	Borrower H	Manufacturing	18	3
9	Borrower I	Real estate, leasing and service	17	
10	Borrower J	Manufacturing	16	
11	Borrower K	Construction	10	
12	Borrower L	Finance and insurance	10	2
13	Borrower M	Manufacturing	10	10
14	Borrower N	Other service	9	4
15	Borrower O	Real estate, leasing and service	8	
16	Borrower P	Other service	8	1
17	Borrower Q	Transportation, storage, and communication	6	
18	Borrower R	Other service	6	3
19	Borrower S	Other service	6	
20	Borrower T	Construction	5	
			₩	396
			₩	104

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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.

In 2015, we sold non-performing loans in the amount of ₩205 billion to third parties, including ₩112 billion transferred to Ivy Hankang Ltd., a real estate project financing company wholly owned by KCC Corporation. Loans transferred to third parties generally meet the criteria of true sale and are derecognized accordingly.

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The following table presents a roll-forward of our non-performing loans in 2015.

	(In billions of Won)	
Non-performing loans as of December 31, 2014	₩	1,286
Additional non-performing loans due to delinquency		884
Loans sold		(205)
Loans charged off		(376)
Loans modified and returned to performing		(44)
Other adjustments <sup>(1)</sup>		(212)
Non-performing loans as of December 31, 2015	₩	1,333

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,									
	2011		2012		2013		2014		2015	
	(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	₩ 1,634	63.4%	₩ 1,700	60.7%	₩ 1,576	63.7%	₩ 1,502	60.1%	₩ 1,357	58.5%
Public and other	19	0.7	14	0.5	10	0.4	11	0.4	8	0.4
Loan to banks	13	0.5	11	0.4	5	0.2	12	0.5	10	0.4
Lease financing	14	0.5	33	1.2	21	0.9	26	1.0	29	1.3
	1,680	65.2	1,758	62.8	1,612	65.1	1,551	62.0	1,404	60.6

Total  
corporate

**Retail**

Mortgages  
and home  
equity

	19	0.7	23	0.8	26	1.1	31	1.2	33	1.4
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Other retail	202	7.8	275	9.8	190	7.7	198	7.9	206	8.9
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Total retail	221	8.6	298	10.6	216	8.7	229	9.2	239	10.3
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**Credit  
cards**

	676	26.2	744	26.6	648	26.2	721	28.8	675	29.1
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Total  
allowance  
for loan  
losses

	₩ 2,577	100.0%	₩ 2,800	100.0%	₩ 2,476	100.0%	₩ 2,501	100.0%	₩ 2,318	100.0%
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Our total allowance for loan losses decreased by ₩183 billion, or 7.32%, to ₩2,318 billion as of December 31, 2015 from ₩2,501 billion as of December 31, 2014, primarily due to improvement in asset quality of our corporate loans largely resulting from an increase in the sale, transfer and charge-offs of non-performing loans.

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 a 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.

**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.

	2011	2012	2013	2014	2015
	(In billions of Won, except percentages)				
Balance at the beginning of the period	₩ 2,852	₩ 2,585	₩ 2,800	₩ 2,476	₩ 2,501
Amounts charged against income	864	1,325	1,082	895	1,022
Gross charge-offs:					
Corporate:					
Corporate loans	(960)	(844)	(799)	(515)	(731)
Public and other	(1)	(1)			(2)
Loan to banks					
Lease financing	(14)	(19)	(33)	(16)	(60)
Retail:					
Mortgage and home equity	(1)	(4)	(4)	(3)	
Other retail	(80)	(130)	(242)	(153)	(128)
Credit cards	(447)	(486)	(657)	(500)	(520)
Total gross charge-offs	(1,503)	(1,484)	(1,735)	(1,187)	(1,441)
Recoveries:					
Corporate:					
Corporate loans	75	75	150	177	88
Public and other		6		11	
Loan to banks					
Lease financing	2	2	1	2	1
Retail:					
Mortgage and home equity	6				3
Other retail	37	32	28	19	24
Credit cards	283	257	217	182	171
Total recoveries	403	372	396	391	287
Other	(39)	2	(67)	(74)	(51)
Net charge-offs	(1,139)	(1,110)	(1,406)	(870)	(1,205)
Balance at the end of the period	₩ 2,577	₩ 2,800	₩ 2,476	₩ 2,501	₩ 2,318
Ratio of net charge-offs during the period to average loans outstanding during the period	0.78%	0.55%	0.68%	0.41%	0.51%
<b>Loan Charge-offs</b>					



Our gross charge-offs increased by 21.4% from ₩1,187 billion in 2014 to ₩1,441 billion in 2015, primarily due to our ongoing efforts to improve asset quality. 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 2015, the charge-off on restructured loans amounted to ₩310 billion, of which ₩51 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 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.

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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 12 months;

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

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

domestic loans that are required by the Financial Supervisory Service to be charged-off, or loans held by our foreign subsidiaries or branches for which a charge-off or special provisioning is required by the relevant regulatory authority.

### *Timeline for Charge-off*

Shinhan Bank's loans to be charged-off must be charged-off within one year of the month they are deemed to be uncollectible. If such loans are not charged-off within one year, the reason for the delay must be reported to Shinhan Bank's Audit Department.

### *Procedure for Charge-off Approval*

An application for Shinhan Bank's loans to be charged-off is submitted by the relevant branch or department to the Credit Collection Department. The Credit Collection Department refers the application to the Audit Department for their review to ensure compliance with the Bank's internal procedures for charge-offs. The Credit Collection Department, after reviewing the application to confirm that it meets relevant requirements, seeks approval from the Financial Supervisory Service for the charge-offs, which is typically granted. Once the Financial Supervisory Service approves (except for household loans with estimated losses of ₩5 million or less, whose charge-off is considered automatically approved by the Financial Supervisory Service), loans are charged-off upon approval by 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 and are classified as charged-off loans. 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. The General Manager of the Credit Collection Department must report to the Financial Supervisory Service the amounts of loans permanently written off or recovered during each reporting period.

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### *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 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, which are overdue for more than 12 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 finance-related 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 Fair Value**

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

	As of December 31, 2013		As of December 31, 2014		As of December 31, 2015	
	Book Value	Fair Value	Book Value	Fair Value	Book Value	Fair Value
	(In billions of Won)					
<b>Financial assets designated at fair value</b>						
Marketable equity securities	₩ 2,173	₩ 2,173	₩ 1,318	₩ 1,318	₩ 1,364	₩ 1,364
Debt securities:						
Korean treasury and governmental agencies	172	172	60	60	104	104
Debt securities issued by financial institutions	229	229	539	539	837	837
Corporate debt securities	780	780	816	816	937	937
Debt securities issued by foreign government						
Mortgage-backed and asset-backed securities	7	7	4	4	2	2
Others						
Total Fair Value Through Profit and Loss	₩ 3,361	₩ 3,361	₩ 2,737	₩ 2,737	₩ 3,244	₩ 3,244
<b>Available-for-sale securities</b>						
Marketable equity securities	₩ 4,888	₩ 4,888	₩ 4,562	₩ 4,562	₩ 4,929	₩ 4,929
Debt securities:						
Korean treasury and governmental agencies	3,707	3,707	3,083	3,083	3,606	3,606
Debt securities issued by financial institutions	12,842	12,842	11,922	11,922	15,594	15,594
Corporate debt securities	10,594	10,594	10,515	10,515	6,723	6,723
Debt securities issued by foreign government	589	589	589	589	676	676
Mortgage-backed and asset-backed securities	977	977	747	747	2,438	2,438
Total Available-for-sale	₩ 33,597	₩ 33,597	₩ 31,418	₩ 31,418	₩ 33,966	₩ 33,966
<b>Held-to-maturity securities</b>						
Debt securities:						
	₩ 5,585	₩ 5,828	₩ 7,723	₩ 8,344	₩ 9,432	₩ 10,413

Korean treasury and governmental agencies						
Debt securities issued by financial institutions	1,406	1,426	1,574	1,607	1,264	1,315
Corporate debt securities	3,785	3,874	3,860	4,049	2,902	3,136
Debt securities issued by foreign government	135	135	62	62	97	97
Mortgage-backed and asset-backed securities	120	117	154	160	2,497	2,528
<b>Total Held-to-maturity</b>	<b>₩ 11,031</b>	<b>₩ 11,380</b>	<b>₩ 13,373</b>	<b>₩ 14,222</b>	<b>₩ 16,192</b>	<b>₩ 17,489</b>
<b>Trading Securities</b>						
Marketable equity securities	₩ 2,693	₩ 2,693	₩ 2,861	₩ 2,861	₩ 3,043	₩ 3,043
Debt securities:						
Korean treasury and governmental agencies	866	866	1,942	1,942	3,255	3,255
Financial institutions	6,035	6,035	8,312	8,312	6,826	6,826
Corporations	7,676	7,676	10,731	10,731	9,256	9,256
Mortgage-backed and asset-backed securities	679	679	189	189	104	104
Debt securities issued by foreign governments	7	7	103	103	5	5
Other trading assets	77	77	224	224	149	149
<b>Total Trading</b>	<b>₩ 18,033</b>	<b>₩ 18,033</b>	<b>₩ 24,362</b>	<b>₩ 24,362</b>	<b>₩ 22,638</b>	<b>₩ 22,638</b>
<b>Total securities</b>	<b>₩ 66,022</b>	<b>₩ 66,371</b>	<b>₩ 71,890</b>	<b>₩ 72,739</b>	<b>₩ 76,040</b>	<b>₩ 77,337</b>

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

The following table categorizes our securities by maturity and weighted average yield as of December 31, 2015.

	As of December 31, 2015														
	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				
	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	1.61%	₩	53	1.70%	₩	10	1.97%	₩	0.00%	₩	104	1.69%	
Debt securities issued by financial institutions		20	2.21%		606	2.09%		211	2.82%		0.00%		837	2.28%	
Corporate debt securities		75	0.90%		757	2.11%		105	2.32%		0.00%		937	2.04%	
Mortgage Backed Securities and asset Backed Securities		2	1.97%			0.00%			0.00%		0.00%		2	1.97%	
Total	₩	138	1.32%	₩	1,416	2.09%	₩	326	2.64%	₩	0.00%	₩	1,880	2.13%	
<b>Available-for-sale securities:</b>															
Korean treasury securities and government agencies	₩	451	2.17%	₩	2,345	2.18%	₩	717	2.62%	₩	93	2.62%	₩	3,606	2.28%
Debt securities issued by financial institutions		6,374	2.06%		8,817	1.99%		393	3.23%		10	4.52%		15,594	2.05%
Corporate debt securities		1,423	2.54%		4,569	2.39%		661	2.75%		70	2.90%		6,723	2.46%
Debt securities issued by foreign governments		279	1.89%		283	6.80%		46	8.25%		68	4.21%		676	4.52%
		644	1.71%		1,717	1.92%		77	2.76%			0.00%		2,438	1.89%



## Mortgage-backed securities and asset-backed securities

Total	₩ 9,171	2.11%	₩ 17,731	2.18%	₩ 1,894	2.93%	₩ 241	3.23%	₩ 29,037	2.22%
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**Held-to-maturity securities:**

Korean treasury securities and government agencies	₩ 683	3.73%	₩ 4,786	3.42%	₩ 673	2.91%	₩ 3,290	3.42%	₩ 9,432	3.41%
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Debt securities issued by financial institutions	315	4.32%	459	3.59%	329	4.17%	161	4.26%	1,264	4.01%
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Corporate debt securities	480	3.22%	1,342	3.50%	412	3.71%	668	3.60%	2,902	3.50%
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Debt securities issued by foreign governments		7.59%	10	6.68%	53	4.93%	34	7.66%	97	6.09%
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Mortgage-backed securities and asset-backed securities	40	2.10%	1,491	2.29%	858	2.41%	108	3.37%	2,497	2.37%
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Total	₩ 1,518	3.65%	₩ 8,088	3.24%	₩ 2,325	3.09%	₩ 4,261	3.51%	₩ 16,192	3.33%
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**Trading securities:**

Korean treasury securities and government agencies	₩ 360	1.63%	₩ 2,280	1.80%	₩ 525	2.14%	₩ 90	2.17%	₩ 3,255	1.84%
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Debt securities issued by financial institutions	3,707	1.74%	3,046	1.88%	20	2.37%	53	3.27%	6,826	1.81%
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Corporate debt securities	7,599	1.61%	1,643	2.24%	13	2.73%	1	2.69%	9,256	1.72%
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Debt securities issued by foreign governments		0.00%	5	1.03%		0.00%		0.00%	5	1.03%
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Mortgage-backed securities and asset-backed securities	43	1.87%	31	2.18%	30	2.31%		0.00%	104	2.09%
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Total	₩ 11,709	1.66%	₩ 7,005	1.94%	₩ 588	2.17%	₩ 144	2.58%	₩ 19,446	1.78%
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Total	₩ 22,536		₩ 34,240		₩ 5,133		₩ 4,646		₩ 66,555	
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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, 2015. As of December 31, 2015, 10% of our stockholders equity was ₩3,181 billion.

Name of issuer:	As of December 31, 2015	
	Book Value	Fair Value
	(In billions of Won)	
Ministry of Strategy and Finance	₩ 15,409	₩ 15,675
The Korea Development Bank	₩ 9,774	₩ 9,774
The Bank of Korea	₩ 5,206	₩ 5,213
The Korea Housing Finance Corp	₩ 4,918	₩ 4,943

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.

	2013	As of December 31,	
		2014	2015
	(In billions of Won)		
Commitments to extend credit	₩ 73,464	₩ 74,449	₩ 75,443
Commercial letters of credit	3,045	2,987	2,377
Other <sup>(1)</sup>	26,743	28,742	22,327
Total	₩ 103,252	₩ 106,178	₩ 100,147

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

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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 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** **Other 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, 2015, 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, 2015</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	₩ 55,448	₩ 807	₩ 608
Swaps	19,643	395	535
Options	2,430	18	11
Sub-total	77,521	1,220	1,154
Interest rate derivatives:			
Future and forward contracts	2,089		
Swaps	76,669	474	471
Options	1,231	10	12
Sub-total	79,989	484	483
Credit derivatives:			
Swaps	1,154	15	20
Sub-total	1,154	15	20

Equity derivatives:			
Swaps and forward contracts	3,708	18	519
Options	8,970	64	84
Future contracts	385		1
<b>Sub-total</b>	<b>13,063</b>	<b>82</b>	<b>604</b>
Commodity derivatives:			
Swaps and forward contracts	1,147	10	154
Options	28	1	

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	As of December 31, 2015		
	Underlying Notional Amount <sup>(1)</sup>	Estimated Fair Value Assets	Estimated Fair Value Liabilities
	(In billions of Won)		
Future contracts	56		
Sub-total	1,231	11	154
<b>Total</b>	<b>₩ 172,958</b>	<b>₩ 1,812</b>	<b>₩ 2,415</b>
<b>Nontrading:</b>			
Hedge accounting:			
Foreign exchange derivatives:			
Swaps	₩ 2,465	₩ 124	₩ 23
Future and forward contracts	1,230	5	35
Interest rate derivatives:			
Swaps	7,680	53	126
<b>Total</b>	<b>₩ 11,375</b>	<b>₩ 182</b>	<b>₩ 184</b>

*Note:*

(1) Notional amounts in foreign currencies were converted into Won at prevailing exchange rates as of December 31, 2015.

**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.

	2013		2014		2015	
	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)						
Interest-bearing deposits:						
Demand deposits	₩ 19,531	0.65%	₩ 21,871	0.57%	₩ 26,365	0.44%
Savings deposits	40,139	0.96	45,622	0.87	56,083	0.70
Time deposits	112,134	3.00	112,469	2.58	113,932	2.03
Other deposits	1,680	2.01	2,151	1.32	3,555	1.20
Total interest-bearing deposits	₩ 173,484	2.26%	₩ 182,113	1.89%	₩ 199,935	1.43%

*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, 2015.

	<b>As of December 31, 2015</b>		
	<b>Certificates of Deposit</b>	<b>Other Time Deposits</b>	<b>Total</b>
	<b>(In billions of Won)</b>		
Maturing within three months	₩ 1,466	₩ 30,923	₩ 32,389
After three but within six months	861	17,776	18,637
After six but within 12 months	1,474	33,739	35,213
After 12 months	270	4,258	4,528
<b>Total</b>	<b>₩ 4,071</b>	<b>₩ 86,696</b>	<b>₩ 90,767</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.

**Table of Contents****Short-term Borrowings**

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	2013			2014			Year-end Interest Rate	Average Balance Outstanding	Year-end Interest Rate	Average Balance Outstanding	Year-end Interest Rate	Average Balance Outstanding
	Highest Weighted Balances at Any Month-end	Average Interest Rate <sup>(2)</sup>	Year-end Interest Rate	Highest Weighted Balances at Any Month-end	Average Interest Rate <sup>(2)</sup>	Year-end Interest Rate						
1,373	₩ 1,531	0.97%	0.10 - 1.25%	₩ 1,478	₩ 1,251	₩ 1,478	0.84%	0.10 - 1.00%	₩ 2,073	₩ 1,712	₩ 2,073	2.00%
2,397	3,335	2.93	0.01 - 5.08	2,649	2,942	3,729	2.35	0.10 - 9.00	643	2,368	5.00	5.00
5,540	9,925	1.52	0.00 - 6.17	12,809	10,750	12,901	1.03	0.00 - 8.91	11,463	8,010	13.00	13.00
9,310	₩ 14,791	1.80%		₩ 16,936	₩ 14,943	₩ 18,108	1.27%		₩ 14,179	₩ 12,090	₩ 20,000	20.00%

(In billions of Won, except for percentages)

*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.

Our group-wide risk management philosophy is to instill a culture of effective risk management and awareness at all levels of our organization and pursue a proper balance between risk and return in our business activities in order to achieve a sustainable growth. 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

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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.

*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

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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 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.

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

### **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 the greatest risk we face. 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 unit. 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.



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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 senior officers of Shinhan Bank specifically charged with granting loan approvals. 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, the level of internal approval required, 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 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

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to review and co-sign the appraisal value of real estate collateral that have an appraisal value exceeding ₩3 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.

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 23 grades (from the highest of AAA to the lowest of D3). 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 D3 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.



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The chart below summarizes the credit approval process of our banking operation. The Master 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.

***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 193 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 63 were identified as such as of December 31, 2015. 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

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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 ₩2 billion or less 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 its corporate customers, Shinhan Bank takes primarily the following measures: (i) systematic monitoring of borrowers with sizable outstanding loans, (ii) heightened monitoring of 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

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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, 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.

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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 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 account holder 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,

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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 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 accountholder's credit score, or (ii) at the request of the accountholder.

Approximately 90% 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.



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**Table of Contents****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 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 Management Committee establishes overall market risk management principles for both the trading and non-trading activities of Shinhan Bank. Based on these principles, the 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. The Risk Policy Committee consists of deputy presidents in charge of Shinhan Bank's seven business groups and 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 with respect to Shinhan Bank's trading activities and the position, VaR, duration gap and market value analysis and net interest income simulation with respect to 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.

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.*

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### *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.

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, including the corresponding risks faced by its overseas branches, on a consolidated basis 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 consolidated 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.

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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, 2015, Shinhan Investment's net open position related to foreign currency-related products was US\$(116.6) million, and its open positions related to the sale of Won-U.S. Dollar forwards and Won-U.S. Dollar futures were US\$(356.8) million and US\$129.0 million, respectively.

Shinhan Capital faces considerable foreign currency exchange rate exposure in respect of its leasing business, but maintains its net exposure below US\$15 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, 2013, 2014 and 2015. Positive amounts represent long exposures and negative amounts represent short exposures.

Currency	As of December 31,		
	2013	2014	2015
	(In millions of US\$)		
U.S. Dollars	\$ 53.1	\$ 101.6	\$ (24.2)
Japanese Yen	(54.7)	(72.4)	9.6
Euro	1.8	(1.5)	(1.2)
Others	698.3	614.8	784.2
Total	\$ 698.5	\$ 642.6	\$ 768.5

*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, 2013, 2014 and 2015, Shinhan Bank held ₩64.6 billion, ₩60.7 billion and ₩76.8 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, 2013, 2014 and 2015, the total amount of equity securities at risk held by Shinhan Investment was ₩16.1 billion, ₩49.1 billion and ₩30.1 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, as of and for the year ended December 31, 2015. For market

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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.

**Trading Portfolio VaR for the Year 2015**

	Average	Minimum	Maximum	As of December 31, 2014
	(In billions of Won)			
<b>Shinhan Bank:<sup>(1)</sup></b>				
Interest rate	₩ 37.3	₩ 33.8	₩ 43.7	₩ 36.0
Foreign exchange <sup>(2)</sup>	45.1	36.5	54.5	44.4
Equities	8.3	7.0	9.0	7.1
Option volatility <sup>(3)</sup>	0.4	0.3	0.6	0.3
Less: portfolio diversification <sup>(4)</sup>	(35.8)	(25.9)	(45.9)	(30.7)
<b>Total VaR<sup>(5)</sup></b>	<b>₩ 55.3</b>	<b>₩ 51.7</b>	<b>₩ 61.9</b>	<b>₩ 57.1</b>
<b>Shinhan Investment:<sup>(1)</sup></b>				
Interest rate	₩ 6.9	₩ 2.7	₩ 16.5	₩ 7.3
Equities	19.4	10.2	64.7	19.1
Foreign exchange	5.7	2.9	10.9	7.5
Option volatility <sup>(3)</sup>	2.6	0.2	5.2	4.4
Less: portfolio diversification <sup>(4)</sup>	(11.7)	(4.1)	(32.1)	(8.5)
<b>Total VaR</b>	<b>₩ 22.9</b>	<b>₩ 11.9</b>	<b>₩ 65.2</b>	<b>₩ 29.8</b>

*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.
- (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 monitors such limits and observance thereof on a daily basis.

*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 expected VaR, on average, once out of 1,000 business days.

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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 amount of losses (either actual or virtual) exceeded the one-day 99% confidence level-based VaR amount once in 2014, by 58% on December 16, 2014, and four times in 2015. The most recent losses exceeded the one-day 99% confidence level-based VaR amount by 10% on October 12, 2015. Virtual losses represent the potential changes in the value of portfolio when simulating the same portfolio with market variables of the next trading day.

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 amount of losses (either actual or virtual) did not exceed the one-day 99% confidence level-based VaR amount in 2013, but exceeded such amount three times in 2014 and six times in 2015. The most recent losses exceeded the one-day 99% confidence level-based VaR amount by 20% on August 24, 2015. The increased frequency of instances in which the amount of losses exceeded the VaR amount in 2015 was primarily because the stock market experienced unusually high volatility when such instances occurred.

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;

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 actually 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.

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*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 the stress test. Stress test is a valuable supplement to VaR since VaR does not cover potential loss if the market moves in a manner which 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 ₩423 billion as of December 31, 2015. 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, 2015, 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 ₩38.0 billion for one day.

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 other abnormalities. 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.

***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.

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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 included in this annual report.

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.

### ***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

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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 the 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 limit, 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 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,

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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 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.

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.

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The following tables show Shinhan Bank's interest rate gaps as of December 31, 2015 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, 2015						Total
	0-3	3-6	6-12	1-2	2-3	Over 3	
	Months	Months	Months	Years	Years	Years	
	(In billions of Won, except percentages)						
Interest-earning assets	₩95,800	₩49,377	₩ 19,300	₩ 14,755	₩ 11,164	₩ 26,562	₩ 216,958
Fixed rates	22,092	6,542	14,017	11,640	7,657	10,286	72,234
Floating rates	72,829	42,275	3,993	2,835	3,186	16,035	141,154
Interest rate swaps	880	560	1,290	280	320	240	3,570
Interest-bearing liabilities	₩87,134	₩31,810	₩ 54,541	₩ 14,667	₩ 10,145	₩ 19,748	₩ 218,044
Fixed liabilities	56,802	31,277	54,321	14,637	10,043	19,048	186,128
Floating liabilities	26,762	533	219	30	102	700	28,346
Interest rate swaps	3,570	0	0	0	0	0	3,570
Sensitivity gap	8,667	17,568	(35,241)	88	1,019	6,814	(1,086)
Cumulative gap	8,667	26,234	(9,006)	(8,918)	(7,899)	(1,086)	(1,086)
% of total assets	3.99%	12.09%	(4.15)%	(4.11)%	(3.64)%	(0.50)%	(0.50)%

**Foreign currency-denominated non-trading bank accounts<sup>(1)</sup>**

	As of December 31, 2015					Total
	0-3	3-6	6-12	1-3	Over 3	
	Months	Months	Months	Years	Years	
	(In millions of US\$, except percentages)					
Interest-earning assets	\$ 17,386	\$ 2,971	\$ 2,721	\$ 2,931	\$ 2,561	\$ 28,570
Interest-bearing liabilities	16,969	2,477	3,768	4,627	2,357	30,198
Sensitivity gap	417	494	(1,047)	(1,696)	204	(1,628)
Cumulative gap	417	911	(136)	(1,832)	(1,628)	(1,628)
% of total assets	1.46%	3.19%	(0.48)%	(6.41)%	(5.70)%	(5.70)%

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.

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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, 2015 and changes in these market values when interest rate increases by one percentage point.

**Duration as of December 31, 2015 (for non-trading Won-denominated bank accounts<sup>(1)</sup>)**

	<b>Duration as of December 31, 2015 (In months)</b>
Interest-earning assets	11.95
Interest-bearing liabilities	10.82
Gap	1.21

*Note:*

(1) Includes merchant banking accounts and derivatives for the purpose of hedging.

**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, 2015 (for non-trading Won-denominated bank accounts<sup>(1)</sup>)**

	<b>Market Value as of December 31, 2015 1% Point</b>		
	<b>Actual</b>	<b>Increase</b>	<b>Changes</b>
	<b>(In billions of Won)</b>		
Interest-earning assets	₩ 220,483	₩ 218,418	₩ (2,065)
Interest-bearing liabilities	218,994	217,231	(1,763)
Gap	1,489	1,187	(302)

*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 the 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 2015 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, 2015 and (b) the same interest rates as of December 31, 2015 and a 1% point increase or decrease in the interest rates.

**Simulated Net Interest Income for 2015**  
**(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	₩ 6,721	₩ 7,938	₩ 5,505	₩ 1,216	18.1%	₩ (1,216)	(18.1)%
Simulated interest expense	3,123	4,032	2,214	909	29.1%	(909)	(29.1)%
Net interest income	3,598	3,906	3,291	307	8.5%	(307)	(8.5)%

*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, 2015, 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 2015 <sup>(1)</sup>			As of December 31	
		Average	Minimum	Maximum		
		(In billions of Won)				
Interest rate mismatch	non-trading assets and liabilities	₩ 239	₩ 146	₩ 472	₩	202

*Note:*

- (1) One-year VaR results with a 99.9% confidence level. Computed based on Shinhan Bank's internal model. Under the 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.

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**Table of Contents***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 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 Investment uses historical interest rate VaR analysis based on its internal model to monitor and manage its interest rate risk. The historical interest rate VaR analysis is made through simulation of net asset value based on the interest rate volatility over the past three years to compute the maximum value at risk at a 99.9% confidence level.

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 one year at a 99.9% 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, 2015, Shinhan Bank held an aggregate amount of ₩134.4 billion of equity interest in unlisted foreign companies (including ₩64.7 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, 2015, Shinhan Bank held equity securities in an aggregate amount of ₩1,849.9 billion in its non-trading accounts, including equity securities in the amount of ₩488.3 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, 2015, Shinhan Bank held Won-denominated convertible bonds in an aggregate amount of ₩59.0 billion, Won-denominated exchangeable bonds in an aggregate amount of ₩1.2 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, exchangeable 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.

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### *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;

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 and 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 a specific liquidity coverage ratio and a foreign currency liquidity ratio. These ratios require us to maintain the relevant ratios 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, including Shinhan Bank, to maintain a liquidity coverage ratio of at least 80.0% as of January 1, 2015, 85.0% as of January 1, 2016, 90.0% as of January 1, 2017, 95.0% as of January 1, 2018 and 100.0% as of January 1, 2019.



The Financial Services Commission defines liquidity coverage ratio as high liquid assets that can be easily converted to cash, as divided by the net amount of cash outflow for the next one month period, under the stress level established according to the liquidity coverage ratio, pursuant to Regulation on the Supervision of the Banking Business, which was amended as of December 26, 2014 to implement the liquidity coverage ratio requirements under Basel III. In addition, the Financial Services Commission requires a foreign currency liquidity ratio, which is defined as foreign currency-denominated liquid assets (including marketable securities) divided by foreign currency-denominated liabilities, of at least 85.0%.

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 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, on a monthly basis.

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The following tables show Shinhan Bank's (i) liquidity coverage ratio and (ii) liquidity status and limits for foreign currency-denominated accounts (including derivatives and merchant banking accounts), each as of December 31, 2015 in accordance with the regulations of the Financial Services Commission.

**Shinhan Bank's Liquidity Coverage Ratio as of December 31, 2015**

	As of December 31, 2015 (in billions of Won, except percentages)	
High liquid assets (A)	₩	40,579
Net cash outflows over the next 1 month (B)		38,983
Cash outflow		55,602
Cash inflow		16,618
Liquidity coverage ratio (A/B)		104.09%

**Shinhan Bank's foreign currency-denominated accounts (including derivatives and merchant banking accounts)**

Foreign Currency Denominated Accounts:	As of December 31, 2015						Total Before Sub-Standard or Below <sup>(1)</sup>	Sub- Standard or Below	Total
	7 Days or Less	1 Month or Less	3 Months or Less	6 Months or Less	12 Months or Less				
(In millions of US\$, except percentages)									
Assets:	\$ 10,860	\$ 19,367	\$ 31,925	\$ 42,752	\$ 51,871	\$ 63,777	\$ 92	\$ 63,869	
Liabilities	9,812	17,227	27,206	33,743	45,404	63,227	0	63,227	
For three months or less:									
Assets			31,925						
Liabilities			27,206						
Liquidity ratio			117.35%						
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.

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

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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, 2015 in accordance with the regulations of the Financial Services Commission.

**Shinhan Card's Won-denominated accounts**

Won-Denominated Accounts	7 Days or 1 Month		3 Months or 6 Months		1 Year	Over	Total
	Less	Less	Less	Less	Less	1 Year	
(In billions of Won, except percentages)							
Assets	₩ 2,252	₩ 10,093	₩ 14,588	₩ 16,803	₩ 19,206	₩ 4,656	₩ 23,863
Liabilities	710	3,155	3,845	4,692	6,300	10,153	16,452
Liquidity ratio	379%						

Shinhan Investment manages its liquidity risk for its Won-denominated accounts by setting a limit of ₩300 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.

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

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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 three outside directors, one of whom is an accounting or financial expert 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 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, 2015, 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

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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 207 key risk indicators.

The Audit Committee of Shinhan Bank, which consists of one standing auditor and two 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, which 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.

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.



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, the Financial Supervisory Service conducted a comprehensive audit of Shinhan Bank from November to

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December 2012, and in July 2013 notified Shinhan Bank of an institutional caution (which does not give rise to significant sanctions unlike in the case of repeated institutional warnings), 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 to the Financial Supervisory Service an investment in an affiliated company of Shinhan Bank. Furthermore, in March 2013 the Financial Supervisory Service conducted a special audit of Shinhan Bank as to incidents of 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. From October 2013 to November 2014, the Financial Supervisory Service also conducted a series of special audits of Shinhan Bank as to incidents of alleged illegal monitoring of customer accounts, and in February 2014, the Prosecutors' Office in Korea also commenced an investigation of Shinhan Bank with respect to same. In December 2015, the Financial Supervisory Service notified Shinhan Bank of an institutional caution and imposed disciplinary actions against three former Shinhan Bank officers after finding that Shinhan Bank had illegally monitored customer accounts, whereas in September 2015, the Prosecutors' Office determined not to prosecute the former officers of Shinhan Bank because of insufficient evidence. In addition, the Financial Supervisory Service conducted a periodic audit of Shinhan Bank from April to May 2015, and as of the date hereof, Shinhan Bank has not received any notifications in connection with such audit.

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 addition, the Financial Supervisory Service conducted a comprehensive audit of Shinhan Card, together with Samsung Card and Hyundai Card, in September 2014, and in November 2015, issued an institutional warning against each of the three credit card companies based on a finding that they had illegally provided personal credit information of potential new cardholders to their credit card sales agents. The Financial Supervisory Service also imposed disciplinary actions against six Shinhan Card employees and assessed a fine of ₩6 million against Shinhan Card as well as similar sanctions against Samsung Card and Hyundai 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.



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### *Upgrades of Risk Management System*

Our recent material upgrades in relation to risk management systems are as follows.

#### *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, India, Europe and Mexico. Shinhan Bank also 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 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 factoring in the credit profile of the head of such enterprises and SOHOs. 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. In 2014, Shinhan Bank reclassified its credit evaluation models for risk assessment of enterprises into the following four categories: (i) IFRS (enterprises subject to external audits under Korean IFRS), (ii) GAAP (enterprises subject to external audits under Generally Accepted Accounting Principles), (iii) small- and medium-size enterprises and (iv) SOHO. Such reclassification was approved by the Financial Supervisory Service, and Shinhan Bank began to implement the system in 2015.

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.

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 July 24, 2015, Law No. 13448). 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), including lending properties with economic values such as monies and securities, guaranteeing obligation performance and other direct or indirect transactions involving transactional credit risk;

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;

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when there is a change of principal shareholders of a bank holding company;

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 extended to customers that, based on our consideration of their business, financial position and future cash flows, do not raise concerns regarding their ability to repay the loans.
Precautionary	Loans extended to customers that (i) based on our consideration of their business, financial position and future cash flows, show potential risks with respect to their ability to repay the loans, although showing no immediate default risk or (ii) are in arrears for one month or more but less than three months.
Substandard	(i) Loans extended to customers that, based on our consideration of their business, financial position and future cash flows, are judged to have incurred considerable default risks as their ability to repay has deteriorated; or
	(ii) the portion that we expect to collect of total loans (a) extended to customers that have been in arrears for three months or more, (b) extended to customers that have incurred serious default risks due to the occurrence of, among other things, final refusal to pay their debt instruments, entry into liquidation or bankruptcy proceedings or closure of their businesses, or (c) extended to customers who have outstanding loans that are classified as doubtful or estimated loss.
Doubtful	Loans exceeding the amount that we expect to collect of total loans to customers that:
	(i) based on our consideration of their business, financial position and future cash flows, have incurred serious default risks due to noticeable deterioration in their ability to repay; or
	(ii) have been in arrears for three months or more but less than twelve months.
Estimated loss	Loans exceeding the amount that we expect to collect of total loans to customers that:
	(i) based on our consideration of their business, financial position and future cash flows, are judged to be accounted as a loss because the inability to repay became certain due to serious deterioration in their ability to repay;

(ii) have been in arrears for twelve months or more; or

(iii) have incurred serious risks of default in repayment due to the occurrence of, among other things, final refusal to pay their debt instruments, liquidation or bankruptcy proceedings or closure of their business.

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.

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***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.

*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 342, 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;

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- (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.

*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

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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 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.



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**Table of Contents*****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.

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.

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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;
- (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

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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 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

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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.

***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.





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### **Principal Regulations Applicable to Banks**

#### ***General***

The banking system in Korea is governed by 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 June 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 on April 1, 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 on May 24, 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.

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 Financial Services Commission 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 Financial Services Commission may order, among others,:

capital increases or reductions;

suspension of officers performance of their duties and appointment of custodians;

stock cancellations or consolidations;

transfers of a part or all of business;

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sale of assets and bar on acquisition of high-risk assets;

closures or downsizing of branch offices or 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; or

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 (typically referred to as Core Capital ) consists of (i) the capital that can absorb losses incurred by a bank such as capital, capital surplus and earned surplus generated from the issuance of common shares (collectively, Common Stock Capital ), and (ii) the capital that can absorb the losses of a bank after depletion of the Common Stock Capital such as capital and capital surplus generated from the issuance of Tier I capital instruments satisfying the requirements designated by the Financial Supervisory Service (collectively, Other Core Capital ). Tier II capital (typically referred to as Supplementary Capital ) represents the capital which is equivalent to, but not included in, the Core Capital and can absorb losses incurred upon the liquidation of a bank such as capital and capital surplus generated from the issuance of Tier II capital instruments satisfying the requirements designated by the Financial Supervisory Service and allowance for bad debts set aside for loans classified as normal or precautionary.

Under the Detailed Regulations on the Supervision of the Banking Business, Tier I capital instruments must satisfy, among others, the following requirements in order to be recognized as Other Core Capital:

- (i) Tier I capital instruments shall have no maturity or maturity of not less than 30 years with conditions under which the bank may extend the maturity without changing the existing terms and conditions;
- (ii) there is no condition to promote the bank to redeem Tier I capital instruments such as a step-up provision;

- (iii) Tier I capital instruments shall constitute unsecured and subordinated obligations of the bank and rank lower than claims of holders of the Supplementary Capital and shall not be recognized as the liabilities in case of the bankruptcy under the Debtor Rehabilitation and Bankruptcy Act of Korea;
- (iv) the requirements for paying dividends shall be determined as of the issuance date and the payment of dividends or interests shall not be determined in connection with the credit rating of the bank;
- (v) Tier I capital instruments shall not be redeemed within five years from the issuance date and the bank shall be able to determine in its sole discretion whether it redeems such instruments even after five years from the issuance date; and
- (vi) the payment of dividends or interests shall be suspended from the date when the bank is designated as a insolvent financial institution under the Act on Structural Improvement of the Financial Industry of Korea or under the Depositor Protection act of Korea as applicable, or the Financial Supervisory

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Service takes measures under the Regulations on the Supervision of the Banking Business such as the managerial improvement recommendation, the managerial improvement request, the managerial improvement order and the emergency measures against the bank to the date when the above-mentioned event is removed;

- (vii) the bank shall be able to revoke in its sole discretion the payment of dividends or interests at any time;
- (viii) the revocation of the payment of dividends or interests shall not be deemed as the event of defaults, and the bank shall be able to use in its sole discretion the amount which was revoked to pay as dividends or interests to redeem any other debts of the bank then due and payable.
- (ix) Tier I capital instruments shall have a provision that requires such instruments to be either written off or converted into common shares upon the occurrence of the events (the Trigger Events ) where the Financial Supervisory Service issues the managerial improvement order against the bank under Article 36 of the Regulations on the Supervision of the Banking Business on the ground that the bank would not have become viable without a write-off or conversion into common shares of such instruments or a public sector injection of capital or equivalent support or the bank is designated as a insolvent financial institution under the Act on Structural Improvement of the Financial Industry of Korea or under the Depositor Protection Act, as applicable.

Under the Detailed Regulations on the Supervision of the Banking Business, Tier II capital instruments must satisfy, among others, the following requirements in order to be recognized as Supplementary Capital:

- (i) Tier II capital instruments shall constitute unsecured and subordinated obligations of the bank and rank lower than all deposits and other senior liabilities of the bank;
- (ii) the maturity shall not be less than five years from the issuance date, and Tier II capital instruments shall not be redeemed within five years from the issuance date;
- (iii) other than the case where the bank is subject to the bankruptcy or liquidation, the holder of Tier II capital instruments shall not have the right to require bank to pay the principal or interests of such instruments earlier than the original due date thereof.;
- (iv) there is no condition to promote the bank to redeem Tier II capital instruments such as a step-up provision, and the bank shall be able to determine in its sole discretion whether to redeem such instruments prior to the maturity date;
- (v) the payment of dividends or interests shall not be determined in connection with the credit rating of the bank;

- (vi) Tier II capital instruments shall have a provision that requires such instruments to be either written off or converted into common shares upon occurrence of the Trigger Events;
  
- (vii) the bank or any person or entity over which the bank exercises substantial control shall not purchase the capital instruments issued by such bank nor provide, directly or indirectly, the funds to acquire the capital instruments by providing any collateral or guaranty or loan in favor of the person or entity which tries to acquire such instruments; and
  
- (viii) the bank shall not enhance, legally or economically, the payment priority of the capital instruments, nor provide, directly or indirectly through its affiliated company, any collateral or guaranty in favor of the person or entity which acquires such instruments.

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 are required to meet the minimum ratio of Tier I and Tier II capital (less any capital deductions) to risk-weighted assets of 8%.

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Furthermore, as Basel III was adopted and is being implemented in stages in Korea starting December 1, 2013, all banks in Korea are required to meet minimum ratios of common stock capital (less any capital deductions) and core capital (less any capital deductions) to risk-weighted assets as set out in the Regulation on the Supervision of the Banking Business. The required minimum ratio of common stock capital (less any capital deductions) to risk-weighted assets is 4.5%, and the required minimum ratio of core capital (less any capital deductions) to risk-weighted assets is 6.0%. In addition, additional capital conservation buffer requirements are being implemented in stages from January 1, 2016 to January 1, 2019. Under such requirements, all banks in Korea are required to maintain a capital conservation buffer of 0.625% from January 1, 2016, which will be gradually increased to 1.25% on January 1, 2017, 1.875% on January 1, 2018 and 2.5% on January 1, 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-weighted assets, the risk-weight ratio of 35% (only in the case where the loan is fully secured by a first ranking mortgage); and

(2) for those banks adopting an internal ratings-based approach for calculating credit risk-weighted assets, 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 June 2004 for the purpose of improving risk management and increasing capital adequacy of banks, was implemented in January 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 first ranking mortgage over the residential property 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 credit card loans and 1.1% in the case of normal credits comprising other credit card receivables);

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 credit card loans and 40% in the case of precautionary credits comprising other credit card receivables);

20% of substandard credits (or 10% in the case of substandard credits comprising assets for which a bank has the right to receive payment in priority pursuant to the Corporate Restructuring Promotion Act of Korea or Paragraph 180, Subparagraph 2 of the Debtor Rehabilitation and Bankruptcy Act of Korea (the Priority Assets ), 65% in the case of substandard credits comprising credit card loans and 60% in the case of substandard credits comprising other credit card receivables);

50% of doubtful credits (or 25% in the case of doubtful credits comprising Priority Assets, 55% in the case of doubtful credits comprising loans to individuals and households and 75% in the case of doubtful credits comprising credit card loans and other credit card receivables); and



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100% of estimated loss credits (or 50% in the case of estimated loss credits comprising of Priority Assets). 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 in an aggregate amount calculated at the same rates applicable to normal, precautionary, substandard, doubtful and estimated loss credits comprising their outstanding loans and other credits as set forth above.

Most recently, in December 2015, the Financial Services Commission designated us, Hana Financial Group, KB Financial Group and NongHyup Financial Group as domestic systemically important bank holding companies and Woori Bank as a domestic systemically important bank and introduced more stringent capital requirements for these financial institutions. According to these new regulations, such financial institutions are required to maintain an additional capital buffer of 0.25% starting on January 1, 2016, with such buffer to increase by 0.25% annually to 1.00% by January 1, 2019.

***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 Korean banks to maintain a liquidity coverage ratio of at least 80.0% as of January 1, 2015, 85.0% as of January 1, 2016, 90.0% as of January 1, 2017, 95.0% as of January 1, 2018 and 100.0% as of January 1, 2019. The Financial Services Commission defines liquidity coverage ratio as high liquid assets that can be easily converted to cash, as divided by the net amount of cash outflow for the next one month period, under the stress level established according to the liquidity coverage ratio, pursuant to the Regulation on the Supervision of the Banking Business, which was amended as of December 26, 2014 to implement the liquidity coverage ratio requirements under Basel III. The Financial Services Commission also requires Korean banks to (1) maintain a foreign currency liquidity ratio due within three months, which is defined as foreign-currency liquid assets due within three months divided by foreign-currency liabilities due within three months, of at least 85.0%, (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 negative 3% 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 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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In December 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 December 26, 2014 and took effect on January 1, 2014 and January 1, 2015, respectively, requires banks with Won-denominated loans of not less than ₩2 trillion in value as of the last month of the immediately preceding quarter to maintain a ratio of Won-denominated loans (excluding certain types of loan from Korea Development Bank, Korean government or Korea Federation of Banks) to Won-denominated deposits (excluding certificates of deposit) and the balance of the covered bonds under the Act on Issuance of Covered Bonds, the maturity of which is not less than five years (only in case when such financing from the issuance of covered bonds is used in Won currency and up to 1% of Won-denominated loan) not more than 1:1. Shinhan Bank's loan-to-deposit ratio as of December 31, 2015 was 98.8%, based on monthly average balances.

***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 persons sharing credit risk with such individuals or legal entities such as companies belonging to the same enterprise groups as defined under 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 an 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 individuals, legal entities and 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).

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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 the cap of 27.9% per annum on interest rates under the Act on Lending Business.

### ***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 ₩5.9 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 pursuant to the criteria under the Detailed Regulations promulgated under the Regulation on the Supervision of the Banking Business), 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 the amount of which exceeds 1% of the sum of the bank's Tier I and Tier II capital (less any capital deductions) at the end of the previous month, unless the bank has lost or expects to lose not more than ₩1 billion as a result thereof, 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;

loans made directly or indirectly to enable a natural or a legal person to buy the bank's own shares; and

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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 volume 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 a 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) shall not exceed 60%;

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 shall not exceed 60%;

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 shall 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;

notwithstanding foregoing, as to loans secured by a collateral of housing (including apartments), the loan-to-value ratio for loans to be amortized over the period of ten years should not exceed 70 percent;

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 (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) of the borrower in respect of loans secured by apartment(s) located in areas of high speculation as designated by the government shall not exceed 40%;

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 shall 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 in the event of the extension of maturity must be repaid first and the number of loans must be eventually reduced to one.

the bank is prohibited from extending home equity loans to minors; and

the bank is prohibited from accepting apartments located in areas of high speculation as designated by the government as collateral for company loans with purpose of acquiring such apartments, except for unavoidable cases.



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Notwithstanding foregoing, in order to rationalize the regulations on the housing loans, the Financial Supervisory Service provided the administrative instructions in July 2014 that all financial institutions including banks under the Banking Act are subject to the maximum loan-to-value ratio of 70% (irrespective of the location of the property) and the maximum debt-to-income ratio of 60% (only in respect of apartment units located in the greater Seoul metropolitan area, subject to certain exceptions), from August 1, 2014.

### ***Restrictions on Investments in Property***

A bank may possess real estate property 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.

In the above cases, a bank must satisfy either of the following requirements:

the total investment in companies in which the bank owns more than 15% of the outstanding shares with voting rights does not exceed 15% of the sum of Tier I and Tier II capital (less any capital deductions); or

the total investment in companies in which the bank owns more than 15% of the outstanding shares with voting rights does not exceed 30% of the sum of Tier I and Tier II capital (less any capital deductions) where the acquisition satisfies the requirements determined 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

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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 10% 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 30% 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 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

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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;

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 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.

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**Table of Contents****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.

***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.



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**Table of Contents*****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% 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) borrowing and issuing foreign currency securities after registering itself as a foreign exchange business institutions under the Foreign Exchange Transactions Law, (vi) transferring claims held by the credit card company in connection with its businesses, or (vii) 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.

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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 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

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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.

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;

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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; (iii) satisfaction of the application scoring system for the relevant credit; and (iv) verification of personal identity.

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.



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***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.

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.

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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:

$$\text{Net Equity Ratio} = (\text{Net Operating Equity} - \text{Total Risk}) / \text{Equity Capital Maintenance Requirement for Each Service Unit}$$

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:

$$\text{Net Operating Equity} = \text{Net assets (total assets} - \text{total liabilities)} - \text{the total of items that may be deducted} + \text{the total of items that may be added};$$

$$\text{Total Risk} = \text{market risk} + \text{counterparty risk} + \text{management risk}; \text{ and}$$

$$\text{Equity Capital Maintenance Requirement for Each Service Unit} = \text{Mandatory Equity Capital to be Required for Each Licensed Service Unit} \times 70\%$$

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.

***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.

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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.

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.



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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.

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



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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 and housing loans.

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.

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.

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

In addition to the direct regulation of Shinhan Bank's U.S. branch by the Department and the Federal Reserve, 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 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

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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.

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

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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-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. In addition, the prompt corrective action framework under the Federal Deposit Insurance Corporation Improvement Act of 1991 ( FDICIA ), provides, among other things, for expanded regulation of insured depository institutions, including banks, and their parent holding companies. As required by FDICIA, the federal banking agencies have established five capital tiers ranging from well capitalized to critically undercapitalized for insured depository institutions. Our U.S. bank subsidiary must maintain a minimum 5% Tier I leverage ratio, a 6.5% common equity Tier I ratio, a 8% Tier I risk-based capital ratio and a 10% total risk-based capital ratio to meet the definition of well capitalized under FDICIA's prompt corrective action requirements.

As of December 31, 2015, Shinhan Bank America exceeded all of the capital ratio standards for a well capitalized bank with a Tier I leverage ratio of 14.02%, a common equity Tier I risk-based capital ratio of 18.88%, a Tier I risk-based capital ratio of 18.88% and a total risk-based capital ratio of 19.84%.

The current FDIC capital adequacy guidelines have been 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



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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's current capital ratios satisfy the requirements set forth in the Final Rules, effective January 1, 2015.

*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 the 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 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

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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 greater, has a Tier I risk-based capital ratio of 8.0% or greater, has a common equity Tier I capital ratio of 6.5% or greater, has a Tier I leverage capital ratio of 5.0% or greater, 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 greater, has a Tier I risk-based capital ratio of 6.0% or greater, has a common equity Tier I capital ratio of 4.5% or greater, has a Tier I leverage capital ratio of 4.0% or greater 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%, has a Tier I risk-based capital ratio that is less than 6.0%, has a common equity Tier I capital ratio of less than 4.5%, or has a Tier I leverage capital ratio that is less than 4.0%, (iv) significantly undercapitalized if it has a total risk-based capital ratio that is less than 6.0%, has a Tier I risk-based capital ratio that is less than 4.0%, has a common equity Tier I capital ratio that is less than 3.0%, or has 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's deposits are insured by 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 several years, there have been many failures and near-failures among financial institutions. 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 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.

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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. As the Dodd-Frank Act also removed the prohibition on banks paying 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 \$5 million of brokered deposits outstanding at December 31, 2015.

*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, 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 makes 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.

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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, 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.





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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 24 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:

- 1) Currently in liquidation proceedings.
  - 2) We and our subsidiaries currently own 36.7% in the aggregate.
  - 3) We and our subsidiaries currently own 32.6% in the aggregate.
  - 4) We and our subsidiaries currently own 34.6% in the aggregate.
  - 5) We and our subsidiaries currently own 1.8% in the aggregate.
  - 6) We and our subsidiaries currently own 93.3% in the aggregate.
- 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);

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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);

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);

Shinhan BNP Paribas Asset Management (Hong Kong) Limited (incorporated in Hong Kong).

PT Bank Metro Express (incorporated in Indonesia);

PT Centratama Nasional Bank (incorporated in Indonesia);

Banco Shinhan de Mexico (incorporated in Mexico);

Nam An Securities Co., Ltd. (incorporated in Vietnam); and

PT Shinhan Indo Finance (incorporated in Indonesia).

**ITEM 4.D. Properties**

The following table provides information regarding certain of our properties in Korea.

Type of Facility	Location	Area (In square meters)	
		Building	Site (If Different)
Registered office and corporate headquarters	20, Sejong-daero 9-gil, Jung-gu, Seoul 04513, 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, 2015, Shinhan Bank had a countrywide network of 899 branches. Approximately 27.7% of these facilities were housed in buildings owned by us, while the remaining branches were leased properties. As of December 31, 2015, 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.

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As of December 31, 2015, Shinhan Card had 28 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, 2015, Shinhan Investment had a nationwide network of 108 branches of which we own six of the buildings in which the facilities are located, representing 5.6% of its total branches in Korea. Lease terms are generally from one to two years. As of December 31, 2015, Shinhan Life had 187 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, 2015 was ₩2,705 billion. We do not own any material properties outside of Korea.

### **ITEM 4A. UNRESOLVED STAFF COMMENTS**

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 consolidated total assets as of December 31, 2015 and operate the fourth largest banking business (as measured by consolidated total bank assets as of December 31, 2015 and the largest credit card business (as measured by the total credit purchase volume in 2015) 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 adverse conditions and volatility, which also had an adverse 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.

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 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

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(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 the 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).

In 2015, the average volume of retail loans increased by 12.2% from 2014, primarily as a result of the general decrease in market interest rates and continued increase in demand for housing loans following the implementation of government policies in the second half of 2014 designed to stimulate the real estate market, including the loosening of maximum debt-to-income and loan-to-value ratios. In addition, the volume of mortgage and home equity loans increased as more households chose to purchase homes due to a substantial increase in the amounts of long-term deposits required for house rentals and a general decrease in the supply of homes rented on long-term deposit leases. In 2015, the average volume of corporate loans increased by 8.8% from 2014, principally as a result of the general decrease in market interest rates and increased loan demand from SOHOs and small- and medium-sized enterprises on the back of the Government's policy initiatives to promote the growth of such enterprises.

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 ₩4,350 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.

From 2014 to 2015, both the average yield on interest-earning assets and the average rate on interest-bearing liabilities decreased further (with the former decreasing more than the latter due to the difference in relative maturity profiles), primarily due to the additional cuts in the base interest rate by the Bank of Korea in March and June 2015, 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 4.6% from ₩4,367 billion in 2014 to ₩4,165 billion in 2015. Net interest income after provision for loan losses amounted to ₩3,903 billion and ₩3,572 billion in 2014 and 2015, respectively. Shinhan Bank's operating income decreased by 3.5% from ₩1,797 billion in 2014 to ₩1,734 billion in 2015.

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 ₩4,615 billion in 2013 to



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₩4,597 billion in 2014 and to ₩4,740 billion in 2015, 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 2015 and our current outlook for 2016 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 2016.

***Trends in the Korean Economy***

In 2015, the global economy continued to undergo divergent paths of growth. The growth rate for China's Gross Domestic Product for 2015 decreased to a quarter-century low of 6.9% despite various measures undertaken by the Chinese government to offset the effects of the sluggish economic growth, including cutting interest rates and adjusting the reserve requirements for its banks. Japan and Europe continued their expansionary monetary policies and are expected to maintain the current policy stance in the near term. The U.S. experienced improvement in the labor market and expressed confidence that inflation will be in line with the target rate over the medium-term. In response to such signs of improvement, in December 2015, the U.S. Federal Reserve raised its benchmark interest rate by 0.25 percentage points and announced its intention to gradually increase the rates in the future depending on the economic situation.

In the first half of 2015, the Korean economy experienced a slower-than-expected recovery due to delayed global economic recovery and a decrease in domestic consumption resulting in part from the spread of the Middle East Respiratory Syndrome (MERS). However, downward pressure on the growth rate was slightly restrained in the second half of 2015 due to active stimulation efforts from the Government, ranging from the Bank of Korea's move to cut the basic interest rate to a historic low to the Ministry of Strategy and Finance's implementation of a supplementary fiscal budget.

In 2016, we consider the following as potential risks to the Korean economy: (i) sustained recessionary current account surplus resulting from diminishing imports; (ii) increasing proportion of temporary employment; (iii) steadily increasing household debt; (iv) China's slowing growth and (v) the Korean economy's vulnerability to depreciation of the Japanese Yen. Also, the Government's recently announced initiatives to restructure distressed businesses may contribute to medium- and long-term growth, but is anticipated to restrict economic recovery in the short-term.

As for interest rate movements, since 2009, Korea, like many other countries, has experienced a low interest rate despite some marginal fluctuations, in part due to the Government's policy to stimulate the economy through active rate-lowering measures. Between 2009 and 2014, the base interest rate set by the Bank of Korea remained within the band between 2.00% and 3.25%. In an effort to support Korea's economy in light of the recent slowdown in Korea's growth and uncertain global economic prospects, the Bank of Korea reduced the base interest rate to 1.75% in March 2015 and further reduced such rate to the historic low of 1.50% in June 2015, which has since remained unchanged. In light of the mixed signals on the economic outlook, the Bank of Korea's policy path of interest rates in 2016 and for the foreseeable future remains uncertain.

***Recent Developments and Outlook for the Korean Financial Sector***

*Commercial Banking*

In 2015, major commercial banks in Korea generally experienced modest growth in terms of assets, principally due to a rebound in demand for loans from retail and corporate customers. The asset quality also

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improved to a limited extent in terms of delinquency and non-performing loan ratios. However, net interest margin for commercial banks generally tightened, largely due to the reduction in the Government-set base rate and increasing competition among Korean banks, particularly in relation to certain qualified fixed rate and installment payment loans.

Currently, we are not aware of any major regulatory developments that may have a material adverse effect on the commercial banking industry in Korea. However, the prolonged low-interest rate environment has presented limited opportunities for commercial banks to generate profit by taking advantage of differences between deposits and loans, and fueled intense competition among major commercial banks for quality customers. New services and products recently introduced based on the regulatory changes, such as the account switch service and the individual savings accounts, are also expected to generate competition among banks and between banks and securities firms. Furthermore, with the growing popularity of online financial service platforms, online service providers and technology companies with large-scale user networks, such as Kakao Corp., NAVER and Samsung Electronics have also intensified the competition by making 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. In addition, Internet-only banks, which are expected to commence operations as early as the second half of 2016, may introduce new services and offer promotions to attract customers of the existing commercial banks. Accordingly, commercial banks will likely face 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 2015, credit card companies in Korea generally experienced steady growth in revenues and assets and stable asset quality, in tandem with the modest recovery in the overall Korean economy, despite the temporary declines in consumer demand due to persisting economic uncertainties and the outbreak of the MERS in May and June 2015. Also in 2015, we experienced an increased threat from mobile payment service providers that are leveraging the convergence of financial services and technology, but at the same time continued to pursue opportunities for expansion into new businesses, aided by a favorable regulatory environment that encourages investments in new products and services.

In 2016, we expect that the recent reduction in merchant fees will inevitably lead to reduced revenues for credit card companies. While the overall asset quality of the Korean credit card industry has been improving and delinquency levels are among the lowest they have ever been largely as a result of the credit card companies' improved portfolio management and credit risk practices over the past decade, we believe it will become increasingly important for credit card companies to take precautionary risk management measures in the face of continued economic uncertainties and the high level of household debt. In addition, 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 and mobile service providers become more prevalent.

The Korean credit card market, which has the world's highest level of credit card usage as a percentage of gross domestic product according to statistics released by the Bank of Korea, has moved on from periods of growth into a period of maturity characterized by slow growth. As product differentiation is difficult given the nature of the industry, credit card companies face intense competition. In recent years, competition is further increasing due to new trends such as the expansion of financial and technology companies into markets for new payment systems and the growing presence of financial institutions in markets for mid-range interest rate loans.

*Securities*

In 2015, the securities industry in Korea reported an improved profitability in the brokerage segment due to a rise in the KOSPI index in the first half of 2015, as well as an increase in income from the fixed income segment due to increased sales of financial products resulting from Korea's persistent low interest rate environment. According to data from the Financial Supervisory Service, return on equity for the industry increased to 7.3% in 2015 from 4.1% in 2014.

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In 2016, we expect that profitability for the securities industry will likely remain under pressure due to factors such as the global recession, but with the continuation of low interest rates, we also anticipate a further flow of funds from risk-free assets to investment assets. In the mid- to long-term, we expect funds in the banking sector to flow into financial investment products, strengthening the wealth management segment. The recent spotlight on contingent liability issues concerning real estate investments has also given greater emphasis to the financial stability of securities companies. As a result, we believe securities companies will become differentiated in terms of financial stability based on their risk management capabilities.

In order to enhance the competitiveness of Korea's capital market, the Government is implementing changes such as the liberalization of lending by financial investment companies, deregulation of private equity funds and introduction of the individual savings account (ISA) system. The Government is also planning to strengthen the capital market's international competitiveness through a restructuring of the Korea Exchange, including its transformation into a holding company. 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 acquisition of IM Investment & Securities by Meritz Securities, the proposed acquisition of KDB Daewoo Securities by Mirae Asset, and the proposed acquisition of Hyundai Securities by KB Financial Group). We expect that mergers and acquisitions will continue to play a significant role in shaping the competitive landscape for the securities industry in Korea.

*Life Insurance*

In 2015, volatility in the Korean financial market was exacerbated by uncertainties regarding increases in the base interest rate set by the United States government and the possible hard landing of the Chinese economy, presenting difficulties for the life insurance industry. The persistence of low profit and low growth led to a weak recovery in the savings insurance segment, but the protection-type insurance segment showed notable signs of growth, primarily through new whole life insurance products related to retirement planning and health insurance products. However, the life insurance industry generally experienced difficulty due to the negative net interest margin resulting from low interest rates, heightened regulations on consumer protection and increasing competition among insurers.

In 2016, we may continue to experience negative net interest margins amidst continued slow growth and low interest rates. Accordingly, we anticipate risk management and underwriting capacities to be the key competitive differentiators. Product development and asset management capabilities will also be emphasized as the industry is undergoing constant challenges and regulatory changes. Moreover, in light of the IFRS 4 Phase II to be implemented in 2020 as well as other changes in the business environment, including the convergence of financial industries and utilization of fintech and big data, we believe life insurance companies will need to adopt strategies focused on profitability and efficiency rather than just top line growth.

We are currently not aware of any major regulatory developments that may have a material adverse effect on 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*

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.

In 2015, the asset management industry experienced a meaningful growth in assets under management largely due to an increase in corporate assets, which offset an increase in redemptions by retail customers.

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Although assets under management have grown in the last three years, the improvement in profitability has been limited as a significant majority of the assets under management are from corporate clients, which tend to generally yield low rates of fees.

In 2016, we expect a greater volatility in profit due to growing market uncertainties in the face of a sustained low interest rate environment. As a result, we anticipate that investors will demand stable returns on investments and more diversified investment solutions addressing various risk appetites.

### *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. In addition, on September 30, 2015, the National Assembly of Korea passed an amendment to the Credit Finance Business Act, which, among other things, aims at alleviating restrictions on entry into the credit finance industry by lowering the minimum capital requirements for new entrants. 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 wider 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 loans 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 our overall net interest margin and profitability. 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 funds 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



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savings deposits, repos, discounted bills and senior non-convertible financial debentures) of eight major Korean banks (comprised of Shinhan Bank, Kookmin Bank, Woori Bank, KEB Hana 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, 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
June 30, 2015	2.01	1.79	1.65	2.22	1.75
December 31, 2015	2.11	1.66	1.67	1.90	1.66

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.

## **Critical Accounting Policies**

The notes to our consolidated financial statements contain a summary of our significant accounting policies, including a discussion of recently issued accounting pronouncements. Certain of these policies are critical to the portrayal of our financial condition, since they require management to make difficult, complex or subjective judgments, some of which may relate to matters that are inherently uncertain. We discuss these critical accounting policies below. The accounting policies set out below have been applied consistently to all periods presented in our consolidated financial statements included in this annual report, unless otherwise indicated.

## ***Operating Segments***

An operating segment is a component of our business that engages in business activities from which we may earn revenues and incur expenses, including revenues and expenses that relate to transactions with any of the other segments. Discrete financial information is available for each operating segment, and all operating segments' operating results are reviewed regularly by our chief executive officer to make decisions about resources to be allocated to the segment and assess its performance.

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Segment results that are reported to our chief executive officer include items directly attributable to a segment as well as those that can be allocated on a reasonable basis. Currently, we have four reportable segments: banking, credit cards, securities, life insurance, and others.

### ***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

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foreign currencies at the reporting date are translated to the functional currency at the exchange rate at that date. 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.



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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.

### ***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.