ITEM 3.D. Risk Factors

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

Risks Relating to Our Overall Business

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

We and our subsidiaries in Korea are required to maintain specified capital adequacy ratios. For example, effective January 1, 2015, we and our banking subsidiaries in Korea are required to maintain a minimum Tier I capital adequacy ratio of 6.0%, a common equity Tier I ratio of 4.5% and a BIS ratio of 8.0%. These ratios measure the respective regulatory capital as a percentage of risk-weighted assets on a consolidated basis and are determined based on guidelines of the Financial Services Commission. In addition, our subsidiaries Shinhan

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

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

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

The Financial Supervisory Service amended the Regulation on the Supervision of the Banking Business to implement the capital requirements of Basel III in Korea under which the new Basel III capital requirements were phased in sequentially from December 2013 and became fully effective in January 2015. Under the amended Regulation on the Supervision of the Banking Business, commercial banks in Korea must meet certain minimum capital requirements with respect to risk-weighted assets. Specifically, effective from December 1, 2013, commercial banks are required to maintain a minimum total capital adequacy (BIS) ratio of 8.0%, a minimum common stock capital ratio of 3.5% and a minimum Tier I capital ratio of 4.5% and, effective from January 1, 2015, commercial banks are required to maintain a minimum total capital adequacy (BIS) ratio of 8.0%, a minimum common stock capital ratio of 4.5% and a minimum Tier 1 capital ratio of 6.0%. Effective January 1, 2015, if any bank fails to satisfy the above requirements, such bank will be subject to prompt corrective measures. In addition to such minimum capital requirements, capital conservation buffer requirements will be phased in sequentially from January 2016, at which time commercial banks will be required to reserve at least a 0.625% capital surcharge in its capital conservation buffer, and from January 2019, at which time commercial banks will be required to maintain a capital conservation buffer of 2.5%. If a commercial bank fails to maintain such capital conservation buffer requirements, such bank will be subject to certain restrictions relating to its use of income, such as distributing dividends and purchasing treasury stock. In addition, under the amended Regulation on the Supervision of the Banking Business, equity securities issued after December 1, 2013 must include a contingent capital feature as required under Basel III's capital requirements. For equity securities issued before December 1, 2013, a certain amount thereof will be derecognized annually as equity securities pursuant to the transitional provisions of such amended regulations. However, equity securities issued after September 12, 2010 containing step-up provisions do not benefit from such transitional provisions and are not recognized as equity securities in their full amount. Accordingly, the Series 12 non-voting redeemable preferred shares we issued on April 20, 2011 are not recognized as equity securities. See “Item 10.B. Memorandum and Articles of Incorporation — Description of Preferred Stock — Preferred Stock” for more details regarding our Series 12 non-voting redeemable preferred shares.

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

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

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

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

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

We and our subsidiaries also raise funds in capital markets and borrow from other financial institutions, the cost of which depends on the market rates and the general availability of credit and the terms of which may limit our ability to pay dividends, make acquisitions or subject us to other restrictive covenants. While we and our subsidiaries are not currently facing liquidity difficulties in any material respect, if we or our subsidiaries are unable to obtain the funding we need on terms commercially acceptable to us for an extended period of time for whatever reason, we may not be able to ensure our financial viability, meet regulatory requirements, implement our strategies or compete effectively.

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

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

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

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

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

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

We may incur losses associated with our counterparty exposures.

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

Risks Relating to Our Banking Business

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

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

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

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

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

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

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

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

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

Most of our mortgage and home equity loans are secured by borrowers' homes, other real estate, other securities and guarantees (which are principally provided by the Government and other financial institutions), and a substantial portion of our corporate loans are also secured, including by real estate. As of December 31, 2014, the secured portion of Shinhan Bank's loans amounted to ₩88,899 billion, or 55.6% of its total loans. There is no assurance that the collateral value will not materially decline in the future. Shinhan Bank's general policy for mortgage and home equity loans is to lend up to 40% to 70% of the appraised value of the collateral and to periodically re-appraise such collateral. However, in light of the sustained downturn in the real estate market in Korea, the value of the collateral may fall below the outstanding principal balance of the underlying mortgage loans. Borrowers of such under-collateralized mortgages or loans may be forced to pay back all or a portion of such mortgage loans or, if unable to meet the collateral requirement through such repayment, sell the underlying collateral, which sales may lead to a further decline in the price of real estate in general and set off a chain reaction for other borrowers due to the further decline in the value of collateral. Declines in real estate prices reduce the value of the collateral securing our mortgage and home equity loans, and such reduction in the value of collateral may result in our inability to cover the uncollectible portion of our secured loans. A decline in the value of the real estate or other collateral securing our loans, or our inability to obtain additional collateral in the event of such decline, may result in the deterioration of our asset quality and require us to make additional loan loss provisions. In Korea, foreclosure on collateral generally requires a written petition to a Korean court. Foreclosure procedures in Korea generally take seven months to one year from initiation to collection depending on the nature of the collateral, and foreclosure applications may be subject to delays and administrative requirements, which may result in a decrease in the recovery value of such collateral. There can be no assurance that we will be able to realize the full value of collateral as a result of, among others, delays in foreclosure proceedings, defects in the perfection of collateral and general declines in collateral value. Our failure to recover the expected value of collateral could expose us to significant losses.

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

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

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

Of Shinhan Bank's 20 largest corporate exposures as of December 31, 2014, nine were companies that are or were members of the main debtor groups as identified by the Governor of the Financial Supervisory Service, which are largely comprised of chaebols. As of such date, the total amount of Shinhan Bank's exposures to the main debtor groups was ₩31,225 billion, or 12.8%, of its total exposure. As of that date, Shinhan Bank's single largest outstanding exposure to a main debtor group (mostly comprised of chaebols) amounted to ₩4,375 billion, or 1.8%, of its total exposures. Largely due to the continued stagnation in the shipbuilding and construction industries, current and former member companies of the STX Group, one of the leading conglomerates in Korea, entered into voluntary arrangements with their creditors (including Shinhan Bank) to improve their credit situation, and in October 2013, Keangnam Enterprises Co., Ltd., a construction company in Korea, entered into workout proceedings. In October 2014, Dongbu Steel also entered into a voluntary arrangement with its creditors led by Korea Development Bank, but our exposure to this company remains limited. Partly as a result of our active past efforts to reduce exposure to the shipbuilding and construction sectors, we currently have limited exposure to the aforementioned troubled companies. However, if the credit quality of our exposures to these and other large corporations, including those in the main debtor groups, declines, we may be required to record additional loan loss provisions in respect of loans and impairment losses in respect of securities, which would adversely affect our financial condition, results of operations and capital adequacy. We cannot assure you that the allowances we have established against these exposures will be sufficient to cover all future losses arising from such exposures, especially in the case of a prolonged or renewed economic downturn.

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

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

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

Risks Relating to Our Credit Card Business

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

As of December 31, 2012, 2013 and 2014, Shinhan Card's interest-earning credit card assets amounted to ₩20,027 billion, ₩19,626 billion and ₩20,550 billion, respectively. Our large exposure to credit card and other consumer debt means that we are exposed to changes in economic conditions affecting Korean consumers in general. For example, a rise in unemployment, an increase in interest rates, a downturn in the real estate market, or a general contraction or other difficulties affecting the Korean economy may lead Korean consumers to reduce spending (a substantial portion of which is conducted through credit card transactions), which in turn leads to reduced earnings for our credit card business, as well as to higher default rates on credit card loans, deterioration in the quality of our credit card assets and increased difficulties in recovering written-off assets from which a significant portion of Shinhan Card's revenues is derived. Any of these developments could have a material adverse effect on our business, financial condition and results of operations.

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

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

Risks Relating to Our Other Businesses

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

We enter into and maintain large investment positions in fixed income products, primarily through our treasury and investment operations. We describe these activities in "Item 4.B. Business Overview — Our Principal Activities — Corporate and Investment Banking Services." We also maintain smaller trading positions, including equity and equity-linked securities and derivative financial instruments as part of our operations. Taking these positions entails making assessments about financial market conditions and trends. The revenues and profits we derive from many of these positions and related transactions are dependent on market prices, which are beyond our control. When we own assets such as debt or equity securities, a decline in market prices, for example, as a result of fluctuating market interest rates or stock market indices, can expose us to trading and valuation losses. If market prices move in a way that we have not anticipated, we may experience losses. In addition, when markets are volatile and subject to rapid changes in price directions, the actual market prices may be contrary to our assessments and lead to lower than anticipated revenues or profits, or even result in losses, with respect to the related transactions and positions.

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

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

Other Risks Relating to Us as the Holding Company

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

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

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

Damage to our reputation could harm our business.

We are one of the largest and most influential financial institutions in Korea by virtue of our financial track records, market share and the size of our operations and customer base. Our reputation is critical to maintaining our relationships with clients, investors, regulators and the general public. Our reputation can be damaged in numerous ways, including, among others, employee misconduct (including embezzlement), cyber or other security breaches, litigation, compliance failures, corporate governance issues, failure to properly address potential conflicts of interest, the activities of customers and counterparties over which we have limited or no control, prolonged or exacting scrutiny from regulatory authorities and customers regarding our trade practices, or uncertainty about our financial soundness and our reliability. If we are unable to prevent or properly address these concerns, we could lose our existing or prospective customers and investors, which could adversely affect our business, financial condition and results of operations.

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

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

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

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

While we plan to rigorously defend our positions in the foregoing lawsuits, it is difficult to predict the final outcome of litigation. The total amount in dispute may increase during the course of litigation and other lawsuits may be brought against us based on similar allegations. Accordingly, these lawsuits, especially if the courts finally rule against us, may have a material adverse effect on our business, financial condition and results of operations. In addition, while in response to the past or current claims or in order to prevent future legal claims we have implemented extensive employee training and other operational procedures to provide adequate disclosure, prevent unfair inducement and otherwise comply with all relevant laws and regulations, we cannot assure you that, despite due training and other preventive measures, all of our employees in charge of such sales have not breached disclosure requirements, engaged in unfair inducement or committed similar acts or will not do the same in the future and, as a result, we may face additional claims or litigation in the future, which may have a material adverse effect on our business, reputation, financial condition and results of operations.

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

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

Our activities are subject to cyber security risk.

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

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

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

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

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

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

In response to the growing incidents of voice phishing, regulatory authorities have undertaken a number of steps to protect consumers against voice phishing and other financial scams. There is no assurance, however, that the regulatory activities will have the desired effect of substantially eradicating or even containing the incidents of voice phishing or other financial scams. For example, following an investigation in November and December 2011 of major credit card companies, including Shinhan Card, as to their compliance with regulations on card loan-related voice phishing and the scope of damage suffered by customers as a result of voice phishing, the Financial Supervisory Service issued a number of guidelines for credit companies to comply with in order to minimize damage from voice phishing, including, among others, (i) strengthening identity verification procedures for card loan applications that are made online or through the automated response system, (ii) delaying the timing of loan payout by a few hours following the approval of card loan application, and (iii) giving an option to customers to block card loan applications. In May 2012, Shinhan Card completed all necessary steps to fully comply with these additional guidelines and has been in full compliance since then.

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

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

Risks Relating to Law, Regulation and Government Policy

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

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

In addition, upon implementation of the proposed Financial Consumer Protection Act (currently pending at the National Assembly for a vote), customers of financial services will be entitled to heightened investor protection measures, including additional remedies in the case of “imperfect sales” of financial products based on inadequate disclosure or unfair inducement, such as mandatory compensatory damages, right of rescission, class action eligibility and double damages in case of a statutory violation. We may also become subject to other restrictions on our operations as a result of future changes in laws and regulations, including more stringent liquidity and capital requirements under Basel III, which will be adopted in phases in Korea in consideration of, among others, the pace and scope of international adoption of such requirements. Any of these regulatory developments may have a material adverse effect on our ability to expand operations or adequately manage our risks and liabilities. For further details on the principal laws and regulations applicable to us as a holding company and our principal subsidiaries, see “Item 4.B. Business Overview — Supervision and Regulation.”

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

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

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

In addition, the financial regulators have adopted several measures designed to improve certain lending practices of the commercial banks which practices were perceived as having an unduly prohibitive effect on extending loans to small- to medium-sized enterprises. Moreover, as a way of supporting the Government’s initiative to assist promising start-ups and venture companies, in February 2015 the financial regulators announced that they would encourage the banks in Korea to increase lending to technology companies in the small- to medium-sized enterprise segment by an annual target of ₩20 trillion and to enhance technology-related credit review capabilities. Furthermore, in February 2014, the Financial Services Commission announced that it plans to increase fixed interest rate housing loans and installment principal repayment-based housing loans each as a proportion of the housing loans extended by commercial banks (which loans have historically been, for the most part, variable interest rate loans with the entire principal being repaid at maturity, which is usually rolled over on an annual basis). According to this plan, the target proportion for the fixed interest rate, installment principal repayment housing loans was 20% by the end of 2014, 25% by the end of 2015, 30% by the end of 2016 and 40% by the end of 2017. In addition, an expanded tax deduction limit for interest repayment will be granted for loans with maturity of 10 years or more (compared to 15 years or more prior to this plan). According to the assessment by the Financial Services Commission in January 2015 of the restructured housing loans by banks in Korea as of December 31, 2014, fixed interest rate and installment principal repayment-based housing loans accounted for 23.6% and 26.5%, respectively, exceeding target proportions for 2014. The Financial Services Commission announced that it would continue to examine whether banks meet their targets on an annual basis.

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

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

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

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

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

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

The objective of the Fund is to purchase non-performing assets from project financing companies, professionally manage such assets and later sell them at a profit once these assets have normalized. By doing so, the Fund is expected to enhance the asset quality of financial institutions with significant exposure to unsound project financings by transferring a part of such exposure from such institutions to the Fund, as well as help to normalize the project financing industry. The Fund is not backed by any government guarantee, and the Fund operates based on mutual agreement of the sponsors. The term of the Fund is five years, which may be extended at a general meeting of the sponsors. Upon liquidation of the Fund, each sponsor will be entitled to a share in the net assets of the Fund at the time of liquidation in proportion to their respective contributions to the Fund.

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

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

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

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

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

Risks Relating to Korea

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

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

- fiscal difficulties political turbulence and increased sovereign default risks in select countries in Europe and the resulting adverse effects on the global financial markets;
- adverse change or increased volatility in macroeconomic indicators, including interest rates, inflation level, foreign currency reserve levels, commodity prices (including oil prices), exchange rates (including fluctuation of U.S. Dollar, Euro or Japanese Yen or revaluation of the Renminbi), stock market indices and inflows and outflows of foreign capital;
- adverse developments in the economies of countries and regions that are Korea’s important export markets (such as the United States, China and Japan) and deterioration in economic or diplomatic relations between Korea and its major trading partners or allies, including as a result of trading or territorial disputes or disagreements in foreign policy;
- continued sluggishness in the Korean real estate market;
- a continuing rise in the level of household debt and an increase in delinquency and credit default by retail or small- and medium-sized enterprise borrowers;
- a rise in unemployment or stagnation of real wages;
- an increase in social expenditures to support an aging population or decreases in productivity due to shifting demographics;
- social and labor unrest;
- a decline in consumer confidence and a slowdown in consumer spending and corporate investments;
- a widening fiscal deficit from a decrease in tax revenues and a substantial increase in the Government’s expenditures for fiscal stimulus, unemployment compensation and other economic and social programs;

- political gridlock within the government or in the legislature, which prevents or disrupts timely and effective policy making;
- laws, regulations or other government actions (financial, economic or otherwise) that fail to achieve desired policy objectives, produce adverse unintended consequences or otherwise constrain or distort sound economic activities;
- loss of investor confidence arising from corporate accounting irregularities and corporate governance issues, including in respect of certain *chaebols*; and
- any other developments that has a material adverse effect on the global or Korean economy, such geopolitical tensions (such as in the Crimea peninsula, certain former republics of the Soviet Union, the Middle East and the Korean peninsula), an act of war, a terrorist act, a breakout of an epidemic or natural or man-made disasters (such as the sinking of the Sewol ferry in April 2014, which significantly dampened consumer sentiment in Korea for months).

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

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

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

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

- In December 2014, North Korea allegedly hacked into Sony’s network to prevent the airing of the movie “The Interview” which unfavorably portrays the North Korean leader, which has prompted the United States to consider implementing additional economic sanctions against North Korea.
- In March 2013, North Korea stated that it had entered “a state of war” with Korea, declaring the 1953 armistice invalid, and put its artillery at the highest level of combat readiness to protest the Korea-United States allies’ military drills and additional sanctions imposed on North Korea for its missile and nuclear tests.
- North Korea renounced its obligations under the Nuclear Non-Proliferation Treaty in January 2003 and conducted three rounds of nuclear tests between October 2006 to February 2013, which increased tensions in the region and elicited strong objections worldwide. In response, the United Nations Security Council unanimously passed resolutions that condemned North Korea for the nuclear tests and expanded sanctions against North Korea, most recently in March 2013.
- In December 2012, North Korea launched a satellite into orbit using a long-range rocket, despite concerns in the international community that such a launch would be in violation of the agreement with the United States as well as United Nations Security Council resolutions that prohibit North Korea from conducting launches that use ballistic missile technology.

North Korea’s economy also faces severe challenges, including severe inflation and food shortages, which may further aggravate social and political tensions within North Korea. In addition, reunification of Korea and North Korea may suddenly occur in the future, which would entail significant economic commitment and expenditure by Korea that may outweigh any resulting economic benefits of reunification. Any further increase in tension or uncertainty relating to the military, political or economic stability in the Korean peninsula, including a breakdown of diplomatic negotiations over the North Korean nuclear program, occurrence of military hostilities, heightened concerns about the stability of North Korea's political leadership or its actual collapse, a leadership crisis, a breakdown of high-level contacts or accelerated reunification could have a material adverse effect on our business, financial condition and results of operations, as well as the price of our common shares and our American depositary shares.

Risks Relating to Our American Depositary Shares

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

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

Ownership of our shares is restricted under Korean law.

Under the Financial Holding Companies Act, any single shareholder (together with certain persons in a special relationship with such shareholder) may acquire beneficial ownership of up to 10% of the total issued and outstanding shares with voting rights of a bank holding company controlling national banks such as us. In addition, any person, except for a "non-financial business group company" (as defined below), may acquire in excess of 10% of the total voting shares issued and outstanding of a financial holding company which controls a national bank, provided that a prior approval from the Financial Services Commission is obtained each time such person's aggregate holdings exceed 10% (or 15% in the case of a financial holding company controlling regional banks only), 25% or 33% of the total voting shares issued and outstanding of such financial holding company. The Government and the Korea Deposit Insurance Corporation are exempt from this limit. Furthermore, certain non-financial business group companies (i.e., (i) any same shareholder group with aggregate net assets of all non-financial business companies belonging to such group of not less than 25% of the aggregate net assets of all members of such group; (ii) any same shareholder group with aggregate assets of all non-financial business companies belonging to such group of not less than ₩2 trillion; or (iii) any mutual fund in which a same shareholder group identified in (i) or (ii) above owns more than 4% of the total shares issued and outstanding of such mutual fund) may not acquire beneficial ownership in us in excess of 4% of our outstanding voting shares, provided that such non-financial business group companies may acquire beneficial ownership of up to 10% of our outstanding voting shares with the approval of the Financial Services Commission under the condition that such non-financial business group companies will not exercise voting rights in respect of such shares in excess of the 4% limit. See "Item 4.B. Business Overview — Supervision and Regulation — Principal Regulations Applicable to Financial Holding Companies — Restrictions on Financial Holding Company Ownership." To the extent that the total number of shares of our common stock that you and your affiliates own together exceeds these limits, you will not be entitled to exercise the voting rights for the excess shares, and the Financial Services Commission may order you to dispose of the excess shares within a period of up to six months. Failure to comply with such an order would result in a fine of up to ₩50 million, plus an additional charge of up to 0.03% of the book value of such shares per day until the date of disposal.

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

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

- a registration statement filed by us under the U.S. Securities Act of 1933, as amended, is in effect with respect to those shares; or
- the offering and sale of those shares is exempt from or is not subject to the registration requirements of the U.S. Securities Act.

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

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

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

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

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

The Korean government has the potential ability to exert substantial influence over many aspects of the private sector business community, and in the past has exerted that influence from time to time. For example, the Government has promoted mergers to reduce what it considers excess capacity in a particular industry and has also encouraged private companies to publicly offer their securities. Similar actions in the future could have the effect of depressing or boosting the Korean securities market, whether or not intended to do so. Accordingly, actions by the government, or the perception that such actions are taking place, may take place or has ceased, may cause sudden movements in the market prices of the securities of Korean companies in the future, which may affect the market price and liquidity of our common stock and ADSs.

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

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

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

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

- sudden fluctuations in interest rates or exchange rates;
- extreme difficulty in stabilizing the balance of payments; and
- a substantial disturbance in the Korean financial and capital markets.

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

Other Risks

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

Companies in Korea, including us, are subject to corporate governance standards applicable to Korean public companies which differ in many respects from standards applicable in other countries, including the United States. As a reporting company registered with the Securities and Exchange Commission and listed on the New York Stock Exchange, we are, and in the future will be, subject to certain corporate governance standards as mandated by the Sarbanes-Oxley Act of 2002. However, foreign private issuers, including us, are exempt from certain corporate governance requirements under the Sarbanes-Oxley Act or under the rules of the New York Stock Exchange. For significant differences, see “Item 16.G. Corporate Governance.” There may also be less publicly available information about Korean companies, such as us, than is regularly made available by public or non-public companies in other countries. Such differences in corporate governance standards and less public information could result in less than satisfactory corporate governance practices or disclosure to investors in certain countries.