

**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 the Recent Economic and Market Crisis**

***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 and financial markets. Recent difficulties affecting the European, U.S. and global financial sectors, adverse conditions and volatility in the worldwide credit and financial markets, fluctuations in oil and commodity prices and the general weakness of the European, U.S. and global economy have increased the uncertainty of global economic prospects in general and have adversely affected, and may continue to adversely affect, the Korean economy. Due to recent liquidity and credit concerns and volatility in the global financial markets, the value of the Won relative to the Dollar has also fluctuated significantly in recent years. Furthermore, as a result of adverse global and Korean economic conditions, there has been continuing volatility in the stock prices of Korean companies. While the rate of deterioration of the global economy slowed in the second half of 2009, with some signs of stabilization and improvement in 2010 and 2011, substantial uncertainties have resurfaced in the form of fiscal and financial sector crisis in several European countries (including Italy, Spain, France, Greece and Portugal), a downgrade in the sovereign or other credit ratings of governments and financial institutions in Europe and the United States and signs of cooling of the Chinese economy, and the overall prospects for the Korean and global economy in 2012 and beyond remain uncertain. Although we have exposure to certain troubled European countries, namely Spain, Ireland, Italy and Portugal, our aggregate exposure to such countries only amounted to (Won)44 billion as of December 31, 2011, which is approximately 0.02% of our total assets as of December 31, 2011. Given the insignificance of our exposure, we do not believe that economic, fiscal and/or political uncertainties in such countries will have a material impact on our liquidity, capital resources, financial condition or results of operations. However, any future deterioration of the Korean or global economy generally 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. During the recent global financial crisis, our delinquent and non-performing loans increased significantly before returning largely to pre-crisis levels in 2009 due in part to our preemptive measures and improvements in the general economy. For example, although Shinhan Bank's delinquent loans (loans with principal payments overdue by one day or more or interest payments overdue for one month or more) increased during the recent global crisis, they decreased as the economy showed signs of recovery. In 2010, however, Shinhan Bank's delinquent loans increased due to an increase in delinquent loans to corporate borrowers in the construction and real estate leasing business, which resulted primarily from a sustained downturn in the real estate market. In 2011, Shinhan Bank's delinquent loans further increased primarily due to increased delinquency among retail borrowers in relation to certain primary housing loans and corporate borrowers in the construction and real estate leasing business resulting from the continued slump in the Korean real estate. Accordingly, Shinhan Bank's delinquency ratio (total delinquent loans to total outstanding loans) increased from 0.48% in 2010 to 0.60% in 2011. As for Shinhan Card, its delinquency ratio under the Financial Services Commission guidelines increased from 2.0% in 2010 to 2.3% in 2011 largely as a result of the

increase in Shinhan Card's assets, and it may continue to experience an increase in delinquency ratio as it seeks to maintain or enlarge its assets amid intensifying competition among credit card companies to gain market share.

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

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

#### **Risks Relating to Our Overall Business**

***Competition in the Korean financial services industry is intense, and may further intensify as a result of further deregulation.***

Competition in the Korean financial services industry is, and is likely to remain, intense.

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, 2011, Korea had seven major nationwide domestic commercial banks (including Citibank and Standard Chartered Bank, both of which are domestic commercial banks acquired by global financial institutions), six regional commercial banks and branches and subsidiaries of 38 foreign banks. We believe that foreign financial institutions, many of which have greater experiences and resources than we do, will 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, although in a more limited fashion compared to that prior to the recent global financial crisis. Prior to the crisis, most Korean banks, including Shinhan Bank, focused on enlarging their assets through aggressive loan growth from small- and medium-sized enterprises and retail customers and, to a lesser extent, from large corporate borrowers, while developing fee income businesses, including bancassurance and investment products, as complementary sources of revenue. Following the crisis, the Korean banks, including Shinhan Bank, are increasingly focusing 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, while reducing their credit exposure to small- and medium-sized enterprises. This shift in focus toward stable growth based on less risky assets may result in lower net interest margin and reduced overall profitability, especially as the banks compete for the same pool of quality credit by engaging in price competition or by other means. 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. 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 their lending rates to stay

competitive, which could lead to a decrease in its net interest margins and outweigh any positive impact on the net interest margin from a general rise in market interest rates. Any future decline in Shinhan Bank's customer base or its net interest margins could have an adverse effect on its results of operations and financial condition.

In the credit card sector, Shinhan Card competes principally with existing "monoline" credit card companies, credit card divisions of commercial banks, consumer finance companies, other financial institutions and, recently, credit card service providers allied with mobile telecommunications service providers in Korea. Competition has been historically intense in this sector and the market has shown signs of saturation as existing and new credit card service providers, such as credit card companies spun off from KB Financial Group, made significant investments and engaged 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, recent Government regulations mandating lower merchant fees chargeable to small- and medium-sized businesses are likely to reduce the revenues of credit card companies, including 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 decline if customers with higher credit quality borrow from Shinhan Card's competitors rather than from Shinhan Card.

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. 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, currently the Government is reportedly taking steps to privatize Korea Development Bank, one of the Government's key policy banks, through an initial public offering and in January 2010, the Government announced its intent to sell its controlling stake in Woori Financial Group, one of the top three financial holding companies in Korea in terms of assets as of December 31, 2011 with a similarly ranked banking operation. If Woori Financial Group were to be acquired by a rival bank or financial holding company, the consolidated entity will 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 February 2012, Hana Financial Group, which owns and operates Hana Bank, one of the major commercial banks in Korea, received the regulatory approval to acquire a controlling equity interest in Korea Exchange Bank, another major commercial bank in Korea, from Lone Star Funds, and it is expected that Korea Exchange Bank will eventually merge into Hana Bank. In March 2012, the National Agricultural Cooperative Federation, another policy bank of the Government, was reorganized into a holding company structure pursuant to which several of its financial business units were spun off into separate subsidiaries, including banking, life insurance and non-life insurance units. 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 it is likely that competition between bank-operated credit card companies and independent card companies will increase substantially. For example, in 2009, Hana SK Card was launched through a partnership between Hana Financial Group Inc. and SK Telecom. In addition, BC Card has recently become a subsidiary of KT Group while the KDB

Group and Korea Post have recently announced their intentions to enter the credit card industry. Furthermore, large non-financial institutions, such as mobile telecommunications companies, have also been reported to be considering entry into the Korean credit card and consumer finance businesses by way of convergence with the existing and future mobile telephone networks. Both SK Telecom and Korea Telecom have begun to actively provide mobile phone payment services using advanced mobile phone technology. As these two companies are the two largest telecommunications service providers in Korea serving a substantial majority of the Korean population, a widespread consumer acceptance of mobile phone payment services in lieu of credit card services could pose a serious competitive threat to the existing credit card service providers, including our credit card subsidiary.

Competition in the Korean financial services industry may also intensify as a result of deregulation. For example, the Financial Investment Services and Capital Markets Act, which became effective in February 2009, promotes integration and rationalization of the Korean capital markets and financial investment products industry by permitting a wider range of financial services providers to engage in a broader sphere of financial activities, including depositary services, and has, to a significant extent, removed the regulatory barriers between securities brokerage, asset management, derivative financial services and trust services in favor of creating financial investment companies that may engage in all of the foregoing activities. Accordingly, the Financial Investment Services and Capital Markets Act enables the creation of large financial institutions that can offer both commercial and investment banking and asset management services modeled after the major global financial institutions based in the United States and Europe. Recently, in light of the recent 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. 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, results of operations and financial condition.

***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, we and our banking subsidiaries in Korea are required to maintain a minimum Tier I capital adequacy ratio of 4.0% and a BIS ratio of 8.0%, each on a consolidated basis under IFRS. 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 upon which the guidelines of the Financial Services Commission are based, or other adverse developments affecting our asset quality or equity capital or due to other reasons.

Specifically, beginning on January 1, 2008, the Financial Supervisory Service implemented the new Basel Capital Accord, commonly referred to as Basel II, in Korea, which has affected the measurement of risk by Korean financial institutions, including us and our subsidiaries. Building upon the initial Basel Capital Accord of 1988, commonly referred to as Basel I, which focused primarily on capital adequacy and asset soundness as a measure of risk, Basel II expanded this approach by considering additional risks such as operational risk. Basel II

also instituted new measures that require us and our subsidiaries to take into account individual borrower credit risk and operational risk when calculating risk-weighted assets.

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 are expected to be phased in from January 1, 2013, with full implementation required by January 1, 2019. The minimum common equity tier 1 requirement of 4.5% and additional capital conservation buffer requirement of 2.5% are expected to be phased in sequentially from January 1, 2013 and become fully effective on January 1, 2019. Additional countercyclical capital buffer requirements are also expected to be phased in starting in 2016, in parallel with the capital conservation buffer to a maximum level of 2.5% effective on January 1, 2019, although individual jurisdictions may choose to implement larger countercyclical capital buffers. The leverage ratio will be subject to a supervisory monitoring period, which commenced on January 1, 2011, and a parallel run period, which will commence from January 1, 2013 until January 1, 2017. Further calibration of the leverage ratio will be carried out in the first half of 2017, with a view to migrating to a pillar 1 requirement from January 1, 2018. The Basel Committee has increased capital requirements for trading book and complex securitization exposures. Since January 1, 2012, we have complied with such increased capital requirements and are currently in compliance. On January 13, 2011, the Basel Committee issued further minimum 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. There can be no assurance that such new requirements under Basel III will not require an increase in our banking subsidiaries’ credit risk capital requirements in the future, which may require our banking subsidiaries to either improve their asset quality or raise additional capital.

Our holding company is currently in compliance with Basel I requirements and our banking subsidiaries are currently in compliance with Basel II requirements, and we and our banking subsidiaries are taking active steps to comply with the additional requirements under Basel III, as it becomes applicable.

If the capital adequacy ratios of us or our subsidiaries fall below the required levels, the Financial Services Commission may 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. A substantial part of the liquidity and funding requirements for our banking subsidiaries is met through short-term customer deposits. While the volume of our customer deposits has generally been stable over time, there have been times when customer deposits declined substantially due to the popularity of other, higher-yielding investment opportunities, namely stocks and mutual funds, during times of bullish stock markets. During such times, our banking subsidiaries were required to obtain alternative funding at higher costs. In addition, following the deregulation of depositary and settlement services as a result of the Financial Investment Services and Capital Markets Act, our banking subsidiaries may experience a decrease in customer deposits due to intensified competition among a more diversified group of financial services providers. We and our subsidiaries also raise funds in the 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. In addition, during times of sudden and significant devaluations of the Korean Won against the U.S. dollar as was the case recently amid the global liquidity crisis, Korean commercial banks, including our banking and credit card subsidiaries,

had temporary difficulties in refinancing or obtaining optimal amounts of foreign currency-denominated funding on terms commercially acceptable to us. 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 generally and in Korea. 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, and require us to post additional collateral in financial transactions, any of which could adversely affect our liquidity, net interest margins and profitability, and in turn, our business, financial condition and results of operations.

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

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 currency 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.

***A significant increase in interest rates could decrease the value of our debt securities portfolio and raise our funding costs while reducing loan demand and the repayment ability of our borrowers, which could have a material adverse effect on our asset quality and profitability.***

Commencing in the second half of 2008, interest rates in Korea declined to historically low levels as the government sought to stimulate the economy through active rate-lowering measures. As the Korean economy showed signs of recovery, the Korean government increased the base interest rate by an aggregate of 125 basis points during the period of 2010 and 2011 from 2.0% in 2010 to 3.25% in 2011 to contain inflationary pressures. All else being equal, an increase in interest rates would lead to a decline in the value of traded debt securities. A sustained increase in interest rates will also raise our funding costs, while reducing loan demand, especially among consumers. Rising interest rates may therefore require us to re-balance our assets and liabilities in order to minimize the risk of potential mismatches and maintain our profitability. In addition, rising interest rate levels 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 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 rate levels will increase the interest costs of our retail and corporate borrowers and could 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. Counterparty risk has increased especially in light of the recent credit crisis and global economic downturn. For example, Shinhan Investment, our securities brokerage subsidiary, recorded losses of (Won)91 billion in 2008 as a result of the bankruptcy filing by Lehman Brothers. Similar losses in the future may have a material adverse effect on our business, financial condition and results of operations.

**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 (Won)51,266 billion as of December 31, 2010 and (Won)52,268 billion as of December 31, 2011, representing 27.8% and 26.8%, 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. Prior to the onset of the recent global financial crisis, loans to such enterprises were the targets of aggressive lending by Korean banks, including Shinhan Bank, as part of their campaigns to increase their respective market shares. 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 have close 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. In recent years, some Korean large corporations have expanded into China and other countries with lower labor costs and other expenses through relocating their production plants and facilities to such countries, which 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, as well as aggressive marketing and intense competition among banks to lend to this segment in recent years, have led to a deterioration in the asset quality of our loans to this segment. As of December 31, 2010 and 2011, under IFRS, Shinhan Bank's delinquent loans to small- and medium-sized enterprises were (Won)492 billion and (Won)597 billion, respectively, representing delinquency ratios (net of charge-offs and loan sales) of 0.86% and 1.04%, respectively. If Korean or global economy were to experience another economic downturn, the delinquency ratio for our loans to the small- and medium-sized may rise significantly.

Of particular concern is the significant exposure we have to enterprises in the real estate and leasing and construction industries. As of December 31, 2011, Shinhan Bank had outstanding loans to the real estate and leasing and construction industries (many of which are small- and medium-sized enterprises) of (Won)14,755 billion

and (Won)5,594 billion, respectively, representing 8.86% and 3.36%, respectively, of our 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.

The enterprises in the real estate development and construction industries in Korea, concentrated in the housing market, are currently experiencing a prolonged downturn characterized by reduced real estate demand and stagnant real estate prices, especially in areas outside of Seoul, largely due to a combination of excessive investment in recent years in residential property development projects, sustained efforts by the Korean government to stem speculation in the housing market and ongoing economic sluggishness in Korea and globally. 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 source for their liquidity and cash flow. In addition, we also have limited exposure to borrowers in the shipping and shipbuilding industries, which were disproportionately hurt by the recent economic downturn following a particularly robust period and are currently experiencing slow recovery.

The delinquency ratio for the small- and medium-sized enterprises in the real estate and leasing and construction industries may increase significantly if restructuring of troubled companies in these industries intensifies as a result of a Government initiative or concerted efforts by lending institutions to improve their asset quality. For example, in 2009 and 2010, in an effort to curtail further deterioration in the credit quality of troubled companies in certain industries that have been disproportionately affected by the recent global economic crisis, the Government encouraged a swift review of the credit quality of such companies and restructuring of troubled companies by creditor financial institutions, including Shinhan Bank. In accordance with such program, 29 construction companies became subject to workouts in February and March 2009. In addition, in June 2010, the Government announced that, following review of credit risk relating to 1,985 companies in Korea with outstanding debt of (Won)50 billion or more, 65 of such companies would be subject to restructuring in the form of workout, liquidation or court receivership. Of the 65 companies, 16 were construction companies. According to the Government's announcement, such restructuring was to have a limited impact on the asset quality of the commercial banks in Korea given the relatively strong level of capital adequacy and financial position of commercial banks in Korea to absorb potential losses in respect of these troubled companies, if any. However, there is no assurance that the credit exposure to these or other troubled companies will not increase in the future as a result of an economic downturn or for other reasons, and additional restructuring may follow as a result of a Government initiative or otherwise. 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, Court Receivership or Composition."

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 from this segment in the future, 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, 2011, the secured portion of Shinhan Bank's loans amounted to (Won)79,584.3 billion, or 57.2% 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 60% of the appraised value of collateral and to



periodically re-appraise its 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 loans. 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 in the construction of residential and, to a lesser extent, commercial 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. While the general contractors tend to be large and well-established construction companies, given the sustained downturn in the real estate market and the construction industry in general, there is no guarantee that even such companies will have sufficient liquidity to back up their guarantees made for the benefit of the developers if the real estate development projects do not generate sufficient cash flow from pre-sales of the residential or commercial units. This is particularly the case for development projects outside the Seoul metropolitan area, which in recent years have had lower than expected levels of pre-sales. If defaults arise under our loans to real estate development projects and the general contractors fail to pay the guaranteed amount necessary to cover the amount of our financings, this may have a material adverse effect on our business, financial condition and results of operations.

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

Of Shinhan Bank's 20 largest corporate exposures as of December 31, 2011, seven were companies that are or were members of the main debtor groups 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 (Won)25,618 billion, or 10.5% of its total exposure. As of that date, Shinhan Bank's single largest outstanding *chaebol* exposure amounted to (Won)3,471 billion, or 1.42% of our total exposures. If the credit quality of our exposures to 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.

In May 2010, creditor financial institutions entered into agreements with nine main debtor groups, largely comprised of *chaebols*, under which such groups agreed to undertake plans to improve their financial conditions, including through the sale of subsidiaries. While Shinhan Bank was not the main creditor financial institution to any of these main debtor groups, Shinhan Bank was one of the creditor financial institutions and has exposure to a limited number of such corporations and main debtor groups. While these main debtor groups are making significant efforts to improve their financial conditions, such as by obtaining intragroup loans and entering into agreements to further improve their capital structures, none of them have exited the latest restructuring programs. In addition, there is no assurance that there will not be future restructuring with 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, 2011, we had aggregate guarantees and acceptances of (Won)16,974.3 billion, for which we provided allowances for losses of (Won)84.4 billion. Such guarantees and acceptances include refund guarantees provided by us to shipbuilding companies, which involve guaranteeing a refund payment of the initial cash payment (typically 25% of the contract amount for ship orders) received by shipbuilders from buyers in the event that such shipbuilders are unable to deliver the ships in time or otherwise default under the shipbuilding contracts. In recent years, small- and medium-sized shipbuilding companies have faced increasing financial difficulties due to the global economic downturn 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 (Won)282.8 billion as of December 31, 2011. 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.***

In recent years, credit card and other consumer debt has increased significantly in Korea. As of December 31, 2010 and 2011, Shinhan Card’s credit card assets amounted to (Won)19,460 billion and (Won)19,772 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.

In addition, recent Government regulations aimed at protecting small- and medium-sized enterprises, such as the reduction of fees chargeable to small- and medium-sized merchants, could have a material adverse effect on our revenues. Starting in 2012, the Government enlarged the definition of a small- and medium-sized merchant to those with annual sales of up to (Won)200 million and lowered fees chargeable to such merchants to 1.8%. The Government has also recently implemented measures regulating marketing costs in order to control

excessive marketing campaigns and curtail undue marketing expenses. While the regulations lowering merchant fees is expected to have a negative impact on Shinhan Card's revenues, we believe that such negative impact will be partially offset by the Government's regulations restricting marketing expenses to reasonable levels. However, the Government may, in the future, impose further reduction in merchant fees chargeable by credit card companies. Furthermore, the Government may also introduce tax incentives and other measures to encourage the use of check cards (akin to debit cards in the United States where all outstanding balances are settled monthly) 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. In line with industry practice, Shinhan Card restructured certain of its delinquent loan balances. As of December 31, 2011, these restructured loans outstanding amounted to (Won)192 billion.

***Competition in the Korean credit card industry is intense and growing market saturation in the credit card sector may adversely affect growth prospects and profitability of Shinhan Card.***

Competition in the credit card and consumer finance businesses remains intense as existing credit card companies, commercial banks, consumer finance companies and other financial and mobile telecommunications institutions in Korea have made significant investments and engaged in aggressive marketing campaigns and promotions in these areas, notwithstanding the recent introduction of stricter regulatory measures, such as the reduction of merchant fees chargeable by credit card companies and the regulation of their marketing expenses. While the rapid increase in competition has somewhat subsided due to the less favorable regulatory environment engendered by recent implementation of various new laws such as restrictions on excessive marketing expenses and lowering of certain categories of merchant fees, competition remains intense. The growth, market share and profitability of our credit card subsidiary'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, such as changes in consumer confidence levels, spending patterns or public perception of credit card usage and consumer debt. For example, other credit card issuers may compete with Shinhan Card for customers by offering lower interest rates and fees, higher credit limits, different product offerings and/or better customer service, which may lead to a loss by Shinhan Card of accounts and/or account balances to competing credit card issuers. Customer attrition from any or all of Shinhan Card's products, together with any lowering of interest rates or fees that Shinhan Card might implement to retain customers and higher marketing expenses could reduce its revenues and earnings. As the credit card market further matures and becomes more saturated in terms of the number of cardholders and transaction volume, 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.

Shinhan Card's ability to maintain its market position and continue its asset growth in the future will depend on, among others, its ability to (i) develop and market new products and services that are attractive to its customers, (ii) generate funding at commercially reasonable rates and in amounts sufficient to support preservation of assets and further asset growth, (iii) develop the personnel and systemic infrastructure necessary to manage its growth and increasingly diversified business operations and (iv) manage increasing delinquencies. In addition, external factors such as competition and Government regulation in Korea may limit Shinhan Card's ability to maintain its growth, and economic and social developments in Korea, such as changes in consumer confidence levels or spending patterns, as well as changes in the public perception of credit card usage and consumer debt, could have an adverse impact on the growth of Shinhan Card's credit card assets in the future. Furthermore, if Shinhan Card fails to simultaneously manage its asset quality and its asset growth or sacrifices asset quality in exchange for asset growth, its delinquency ratio may be adversely affected. If the rate of growth of Shinhan Card's assets declines or becomes negative or its delinquency ratio increases, our business, financial condition and results of operations may be adversely affected.

***Shinhan Card may not be able to increase consumer and business spending and borrowing on its card products or manage the costs of its cardholder benefits intended to stimulate such use.***

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. 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 or in containing costs or cardholder benefits, its financial condition, results of operations and cash flow could be negatively affected.

***Our customers may become victims to "voice phishing", other financial scams or cyber security breaches, 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. However, 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. In addition, in November and December 2011, the Financial Supervisory Service conducted an investigation of major credit card companies, including Shinhan Card, in relation to card loan-related voice phishing, with a focus on whether these companies are in compliance with the related FSS regulations and the scope of damage suffered by their customers as a result of voice phishing. No official results of such investigation have been made available to us or Shinhan Card to-date.

Pursuant to guidelines set forth by the Credit Finance Association of Korea, credit card companies in Korea, including Shinhan Card, adopted a standard compensation scheme for victims of voice phishing, under which the credit card companies would compensate up to 50% of the damage suffered by such victims, depending on the nature of the victims (for example, more compensation if the victim is handicapped or at the lowest income bracket) and the level of precautionary steps undertaken by the relevant credit card company before approving the credit card loans or cash advances in connection with voice phishing; provided that if the applicant personally made the application, for example, through an ATM terminal or an outcall procedure was undertaken to confirm the personal identity of the applicant, no compensation would be made. The compensation scheme applies to claims of voice phishing received for the period from January 1, 2011 to January 31, 2012. 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. Accordingly, we believe that Shinhan Card's liability for voice phishing claims filed after such date will be substantially limited.

In 2011, Shinhan Card received 1,209 customer claims in relation to voice phishing in the aggregate amount of (Won)8 billion. In 2011, Shinhan Card reserved as other provisioning (Won)3 billion to cover potential liability in

relation to non-frivolous claims of voice phishing in the amount of (Won)8 billion. The average payout to-date has been approximately (Won)3 million per claim. No voice phishing related complaints have been filed against any of our other subsidiaries.

Other than voice phishing, the cyber security risks relating to our businesses primarily involve the potential security breaches of our customers' personal and financial information and illegal use thereof through system-wide "hacking" or other means. We are fully committed to maintaining the highest standards of cyber security and consumer protection measures and upgrading them continually. We believe that our ISO 27001-certified security management system is among the best-in-class in the industry. Our security management system continuously monitors for signs of potential cyber attacks, and is designed to provide early warning alerts to enable prompt actions on our part. We also actively provide employee training on cyber security and have adopted advanced security infrastructure for online financial services such as mandatory website certification and keyboard security functions. In addition, in compliance with applicable regulations we have recently obtained insurance to cover cyber security breaches up to (Won)2 billion in relation to our banking business, (Won)3 billion for our securities investment business and (Won)1 billion for our credit card business.

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 as discussed above, we have not experienced any material breaches of cyber security in the past. 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, other major financial institutions in Korea 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, which may have a material adverse effect on our business, financial condition and results of operations. In addition, we may be required to incur substantial costs in terms of compensation to victims of cyber security attacks and compliance costs with the present and future regulatory restrictions as well as suffer reputational costs in the case of a widespread cyber security breach.

#### **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 securities, a decline in market prices, for example as a result of fluctuating market interest rates, 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 the 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 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, to 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**

***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 also 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), 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 techniques may not be fully effective at all times in 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.

Due to the recent global economic slowdown and a deteriorating Korean stock market in the second half of 2008, investment funds whose performance was tied to domestic and foreign stock market indices experienced a sharp fall in their rates of return. Consequently, investors in these funds brought lawsuits against commercial banks in Korea that sold such investment fund products based on the allegation that such banks used defective sales practices in selling such funds, such as failing to comply with disclosure requirements or unfairly inducing them to invest in the funds. For example, in 2009, we, like other commercial banks that sold similar products, became a defendant in lawsuits in connection with the sale of foreign currency derivatives products known as "KIKOs," which stands for "knock-in knock-out," to certain of our customers comprised mostly of small- and medium-sized enterprises. The KIKOs, which are intended to be hedging instruments, operate so that if the value of Korean Won increases to a certain level, we are required to pay the purchasers a certain amount, and if the value of Korean Won falls below a certain level, the purchasers of KIKOs are required to pay us a certain amount. As the Korean Won significantly depreciated against the U.S. dollar in the second half of 2008, purchasers of KIKOs were required under the relevant contracts to make large payments to us, and some of such purchasers filed lawsuits to nullify their obligations under the allegation that we did not sufficiently disclose the risks in investing in KIKOs and unfairly induced them to make such investments. As of December 31, 2011, we had won 35 out of 47 KIKO-related cases at the lower court level. If we lose our cases on appeal, the court may nullify the contracts under which KIKO products were sold and order us to return payments received from the customers. As of December 31, 2011, the aggregate amount of the outstanding KIKO-related claims was (Won)202 billion, for which we set aside (Won)26 billion as allowance.

In addition to the KIKO-related claims, we have also faced complaints and, to a lesser extent, litigation from customers based on claims of (i) inadequate disclosure of risk related to the potential loss of principal when we sold currency forward contracts designed to hedge against currency risks in overseas mutual fund investments, (ii) approval of customer applications for purchases of our investment products with missing information without first confirming such missing items with customers and (iii) our discretionary liquidation of small-size investment funds as permitted under the Financial Investment Services and Capital Markets Act but without first seeking customer approval. In connection with the foregoing claims, we were defendants in four court proceedings for an aggregate claim amount of (Won)1 billion as of December 31, 2011, for which we set aside a minimal amount as allowance.

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 foregoing claims we have implemented extensive employee training and other operational processes and 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 for our daily operations, including billing, online and offline financial transactions settlement and record keeping. We also upgrade from time to time our groupwide customer data-sharing and other customer relations management systems. We may experience disruptions, delays 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 and adversely impact our customers' confidence in us.

**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, capital ratios 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, results of operations and financial conditions.

For example, under the Financial Investment Services and Capital Markets Act, which became effective as of February 4, 2009, financial institutions, including us and our subsidiaries, may offer a broader range of investment products with novel and complex structures, including by way of hedge funds and private equity funds. Such products may involve greater counterparty risks as well as compliance risks associated with inadequate disclosure of investment risks. In addition, upon implementation of the Financial Consumer Protection Act, which is currently being considered by the Financial Services Commission and Financial Supervisory Service, 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. Furthermore, in an effort to curb the substantial rise recently in retail loans in Korea, the regulators may adopt measures and guidelines designed to limit further growth of our retail lending, in particular mortgage and home equity loans that are deemed to be "high-risk" (namely, mortgage and home equity loans of over (Won)50 million (i) whose principal and interest are due at maturity, (ii) whose interest is due periodically over the term of the loan but whose principal is due at maturity, or (iii) whose borrower has more than three mortgage and home equity loans from financial institutions). We may also become subject to other restrictions on our operations as a result of future changes in laws and regulations, including the more stringent liquidity and capital requirements anticipated under Basel III, which is to be adopted in phases starting in 2015 in Korea. Any of these regulatory developments may have a material adverse effect on our ability to expand operations or adequately manage our risks and liabilities.

In addition, violations of law and regulations could expose us to significant liabilities and sanctions. For example, if the Financial Services Commission determines that our financial condition, including the financial conditions of our operating subsidiaries, is unsound, 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, stock cancellations or consolidations, transfers of business, sales of assets, closures of branch offices, mergers with other financial institutions, or suspensions of a part or all of our business operations. If any of such measures is imposed on us or on our subsidiaries as a result of unsound financial condition or failure to comply with minimum capital adequacy requirements or for other reasons, it will have a material adverse effect on our business, financial condition and results of operations.

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.”

***Increased government involvement in the economy and tighter regulation of the financial services industry in Korea in response to a financial crisis or economic downturn could impose greater restrictions on our business and hurt our profitability.***

During the recent global financial crisis and the ensuing economic downturn, many governments worldwide, including the Government, became involved in providing assistance, including by direct investment, to troubled financial institutions and corporations, typically in exchange for increased government monitoring and guidance of the operations of such entities. In Korea, for example, in 2008 and 2009 several major commercial banks, including Shinhan Bank, applied for Government-backed credit lines, which if drawn down would have imposed greater Government monitoring of their operations. While no drawdown has been made and these programs have since terminated, there is no assurance that if the Korean or global economy were to experience another severe crisis, financial institutions in Korea, including us and our subsidiaries, will not require special assistance from the Government, which would generally impose greater government monitoring and restrictions on our business and operations and may have a material adverse effect on our business, results of operations and financial condition.

In light of the widely held perception that the recent global liquidity crisis is at least partly attributable to deficiencies in the risk management systems and capital adequacy of financial institutions, many governments worldwide have taken or are considering taking measures to increase regulatory oversight in these and other areas. Examples of such measures currently being considered by the Government include proposals to further regulate capital and liquidity of financial institutions in line with Basel II and Basel III. There can be no assurance that such measures will have the desired consequences or not have unintended adverse consequences which could hurt our business, results of operations and financial condition or profitability.

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

The Government has encouraged and may in the future encourage lending to or investment in the securities of certain types of borrowers and other financial institutions in furtherance of government initiatives. The Government, through its regulatory bodies such as the Financial Services Commission, has in the past announced lending policies to encourage Korean banks and financial institutions to lend to or invest in particular industries 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. While all of our loans or securities investments are reviewed in accordance with our internal credit review policies or internal investment guidelines and regulations, we, on a voluntary basis, may factor the existence of such policies and encouragements into consideration in making loans or securities investments. In addition, while the ultimate decision whether to make loans or securities investments remains with us and is made based on our internal credit approval procedures and risk management systems independently of Government policies, the Government may in the future request financial institutions in Korea, including us, to make investments in or provide other forms of financial support to particular sectors of the Korean economy as a matter of policy, which financial institutions, including us, may be required to make or may otherwise decide to accept. For example, the Government took various initiatives to support small- and medium-sized enterprises, which were disproportionately affected by the recent downturn in the Korean and global economy.

As part of such initiatives, Shinhan Bank, like other commercial banks in Korea, entered into a memorandum of understanding in April 2009 with the Financial Services Commission under which Shinhan

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Bank would make efforts to, among others, provide greater liquidity into the general economy by extending a sizable volume of loans to small- and medium-sized enterprises. More specifically, the memorandum of understanding provided for the following: (i) in order to facilitate obtaining foreign currency financing during the financial crisis, the Government would guarantee a certain amount of foreign currency-denominated borrowings by Shinhan Bank, which would be used primarily to refinance existing borrowings and, to the extent there are new borrowings, such new borrowings to be used for trading financing by exporting companies and for loans to small- and medium-sized enterprises; (ii) in exchange, Shinhan Bank would facilitate export financing for domestic companies, including through purchase of foreign currencies and other voluntary measures to support small- and medium-sized enterprises such as increasing the frequency of extending maturity for loans by such enterprises and increasing the amount of loans to small- and medium-sized enterprises when measured as a percentage of total loans; and (iii) when commercial banks (including Shinhan Bank) make Won-denominated loans to certain start-up, venture, innovative and other strategic small- and medium-sized enterprises specially designated by the Bank of Korea as “priority borrowers”, the Bank of Korea will provide the underlying funding to these banks at concessionary rates for up to 50% of all such loans made to priority borrowers subject to a monthly-adjusted limit prescribed by the Bank of Korea (currently (Won)5 trillion), provided that if such loans to priority borrowers made by all commercial banks exceed the prescribed limit for a given month, the concessionary funding for the following month will be allocated to each commercial bank in proportion to such bank’s lending to priority borrowers two months prior to the time of such allocation, which has the effect that, if a particular bank lags other banks in making loans to priority borrowers, the amount of funding such bank can receive from the Bank of Korea at concessionary rates will be proportionately reduced.

In tandem with providing additional loans to small- and medium-sized enterprises under the memorandum of understanding, Shinhan Bank has taken active steps to mitigate the potential adverse impacts from making bad loans to enterprises with high risk profiles as a result of the foregoing arrangements, such as by strengthening its loan review and post-lending monitoring processes. However, we cannot assure you that the arrangements contemplated under the memorandum of understanding did not or will not, or similar or other government-led initiatives in the future will not, result in a suboptimal allocation of our loan portfolio from a risk-reward perspective compared to what we would have allocated based on purely commercial decisions in the absence of such initiatives. The government may implement similar or other initiatives in the future to spur the overall economy or encourage the growth of targeted industries. In particular, the government may introduce lending-related initiatives or enforce existing ones in a heightened fashion during times when small- and medium-sized enterprises on average are facing an increased level of financial distress or vulnerability due to an economic downturn, which makes lending to them in the volume and the manner suggested by the government even riskier and less commercially desirable. Accordingly, making loans to small- and medium-sized enterprises in furtherance of the government-led initiatives may 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.

In addition, in light of the sizable non-performing assets from project financings (mostly related to real estate project financings suffering from the persistent slump in the real estate market) by commercial banks (mostly in the lower tier) and merchant banks, in June 2011, the Government established the United PF 1<sup>st</sup> Recovery Private Equity Fund (the “Fund”), a joint-stock private equity fund sponsored by United Asset Management Company Ltd. (“UAMCO”), a government-invested enterprise and the largest purchaser in Korea of non-performing financial assets generally, and seven major commercial and policy banks, namely Woori Bank, Kookmin Bank, Nonghyup Bank, Shinhan Bank, Hana Bank, Korea Development Bank and Industrial Bank of Korea.

Shinhan Bank does not have any involvement in the management or day-to-day operations of the Fund. While Shinhan Bank holds a 13.6% equity interest in the Fund, Shinhan Bank is designated as a limited partner, and under the Fund’s articles of organization the management and day-to-day operations of the Fund are specifically delegated to a general partner designated as the managing partner for the Fund, which is currently UAMCO, a limited liability company established under Korean law whose shareholders are the six banks that have made capital contributions to the Fund. The scope of such delegated management activities are as follows: (i) management and operating of the Fund’s assets and liabilities, (ii) selection of investment targets and exercise

of investment decisions and redemption decisions, (iii) exercise of rights over investment assets, (iv) issuance and distribution of beneficiary certificates underlying the investment assets, (v) distribution of Fund assets, (vi) accounting and recordkeeping, (vii) payment of expenses and liabilities related to the operation of the Fund and (viii) ancillary activities related to the foregoing. Under the Fund's articles of organization, the activities of the general partner acting as the managing 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 view on the activities of the managing partner. The advisory committee's view is not binding, and serves only as a recommendation with respect to certain activities over which the managing partner is authorized to exercise its discretion under the Financial Investment Services and Capital Markets Act. However, in the event 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 (and if applicable, restore) 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 eight sponsors in the aggregate amount of (Won)1,228 billion (consisting of (Won)800 billion in capital contributions and (Won)428 billion in loans). Of such amounts, under the fund organization documents, Shinhan Bank is obligated to make capital contributions of (Won)92 billion (representing a 11.5% equity interest in the Fund in the form of common shares) and loans of (Won)19 billion (representing 4.5% of the total loans made by the sponsors), and Shinhan Bank, together with other sponsors, may be requested to make additional capital contributions and loans upon further purchase by the Fund of non-performing assets from project financings. The amount of funding obligation is proportionate to each sponsor's relative asset size and its exposure to project financings. As of December 31, 2011, Shinhan Bank has made capital contributions of (Won)92 billion and has fulfilled its capital contribution obligations. As for the capital contributions made by Shinhan Bank to-date, these 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, after which it will be liquidated, and 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.

Following the establishment of the Fund in June 2011, Shinhan Bank has sold non-performing project financing assets in the aggregate amount of (Won)114 billion to the Fund and recognized from such sales an aggregate loss of (Won)66 billion before applying allowance for loan losses allocated to such assets and an aggregate loss of (Won)6 billion after applying allowance for loan losses allocated to such assets. Under IFRS, the sale of non-performing project financing assets to the Fund is classified as a true sale, and therefore, gain or loss from such sale is recognized at the time of sale, and no gain or loss is recognized after the time of sale. 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.

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

Curtailling excessive speculation in the real estate market has historically been a key policy initiative for the Government, and it has in the past adopted several regulatory measures, including in relation to retail banking, to affect such policy. 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.

The Government may from time to time take measures to regulate the housing market in order to preempt undue speculation, including by way of imposing restrictions on retail lending, including mortgage and home equity lending. For example, in September 2009, in light of the growing concerns about the rising level of household debt in Korea, which is in large part secured by residential property, the Financial Supervisory Service announced that it will apply stricter debt-to-income ratios for mortgage and home equity lending. Any measure by the Government that is designed to stimulate or curb growth in the real property sector may be premature, result in unintended consequences or contribute to substantial future declines in real estate prices in Korea, which will reduce the value of the collateral securing our mortgage and home equity loans. 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.” Such measures may also have the effect of limiting the growth and profitability of our retail banking business, especially in the area of mortgage and home equity lending.

***Korea’s legislation allowing class action suits related to securities transactions may expose us to additional litigation risk.***

The Act on Class Actions regarding Securities allows class action suits to be brought by shareholders of companies listed on the Korea Exchange, including ours, for losses incurred in connection with the purchase and sale of securities and other securities transactions arising from (i) false or inaccurate statements provided in registration statements, prospectuses and business reports; (ii) insider trading and (iii) market manipulation. This law permits 50 or more shareholders who collectively hold 0.01% or more of the shares of a company at the time when the cause of such damages occurred to bring a class action suit against us and our subsidiaries and our and their respective directors and officers. It is uncertain how the courts will apply this law, however, as this law has been enacted relatively recently and there are few precedents. Litigation can be time-consuming and expensive to resolve, and can divert valuable management time and attention from the operation of a business. We are not aware of any basis for such suit being brought against us, nor, to our knowledge, are there any such suits pending or threatened. Any such litigation brought against us could have a material adverse effect on our business, financial condition and results of operations.

#### **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:

- further deterioration of the fiscal and financial crisis in Europe, downgrades in the sovereign or other credit ratings of the governments and financial institutions in Europe and the United States and instability in the value of the U.S. dollar against other major currencies, which could have adverse effects on the global, and in turn Korean, credit and financial markets;
- inflation levels, volatility in foreign currency reserve levels, commodity prices (including oil prices), exchange rates (particularly against the U.S. dollar), interest rates and stock markets;
- increased reliance on exports to service foreign currency debts, which could cause friction with Korea's trading partners;
- adverse developments in the economies of countries to which Korea exports goods and services (such as the United States, China and Japan), or in emerging market economies in Asia or elsewhere that could result in a loss of confidence in the Korean economy;
- the continued emergence of China, to the extent its benefits (such as increased exports to China) are outweighed by its costs (such as competition in export markets or for foreign investment and relocation of the manufacturing base from Korea to China);
- social and labor unrest or declining consumer confidence or spending resulting from layoffs, increasing unemployment and lower levels of income;
- uncertainty and volatility in real estate prices arising, in part, from the Government's policy-driven tax and other regulatory measures;
- a decrease in tax revenues and a substantial increase in the Government's expenditures for unemployment compensation and other social programs that together could lead to an increased Government budget deficit;
- political uncertainty or increasing strife among or within political parties in Korea, including as a result of the increasing polarization of the positions of the ruling conservative party and the progressive opposition and the upcoming presidential election in December 2012;
- a deterioration in economic or diplomatic relations between Korea and its trading partners or allies, including such deterioration resulting from trade disputes or disagreements in foreign policy; and
- any other developments that has a material adverse effect in the global economy, such as an act of war, a terrorist act, a breakout of an epidemic such as SARS, avian flu or swine flu or natural disasters such as the earthquake and tsunami in Japan in March 2011 and the resulting leakage of nuclear materials, and the related disruptions in the economies of Japan and other countries.

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 stock 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 recent years, there have been heightened security concerns stemming from North Korea's nuclear weapons and long-range missile programs and increased uncertainty regarding North Korea's actions and possible responses from the international community. In April 2009, after launching a long-range rocket over the Pacific Ocean, which led to protests from the international community, North Korea announced that it would permanently withdraw from the six-party talks that began in 2003 to discuss Pyongyang's path to denuclearization. On May 25, 2009, North Korea conducted its second nuclear testing by launching several short-range missiles. In response to such actions, the Republic decided to join the Proliferation Security Initiative, an

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international campaign aimed at stopping the trafficking of weapons of mass destruction, over Pyongyang's harsh rebuke and threat of war. After the United Nations Security Council passed a resolution on June 12, 2009, to condemn North Korea's second nuclear test and impose tougher sanctions such as a mandatory ban on arms exports, North Korea announced that it would produce nuclear weapons and take "resolute military actions" against the international community.

There recently has been increased uncertainty about the future of North Korea's political leadership and its implications for the economic and political stability of the region. In June 2009, Korean and U.S. officials announced that Kim Jong-il, the North Korean ruler who reportedly suffered a stroke in August 2008, designated his third son, Kim Jong-eun, to become his successor. In September 2010, Kim Jong-eun was made a general in the North Korean army, named the vice chairman of the Central Military Commission and appointed to the Central Committee of the Workers' Party in a series of measures widely believed to be part of the succession plan. The succession plan, including its likelihood of success and its implications for the politics and economy of North Korea, however, remains uncertain. In addition, North Korea's economy also faces severe challenges. For example, in November 2009, the North Korean government redenominated its currency at a ratio of 100 to 1 as part of a currency reform undertaken in an attempt to control inflation and reduce income gaps. In tandem with the currency redenomination, the North Korean government banned the use or possession of foreign currency by its residents and closed down privately run markets, which led to severe inflation and food shortages. Such developments may further aggravate social and political tensions within North Korea.

Since the death of the North Korean ruler Kim Jong-il in December 2011, there has been increased uncertainty with respect to the future of North Korea's political leadership and concern regarding its implications for political and economic stability in the region. However, the eventual outcome of such leadership transition remains uncertain. Furthermore, only limited information is available outside of North Korea about Kim Jong-eun, who is reported to be in his late twenties, and it is unclear which individuals or factions, if any, will share political power with Kim Jong-eun or assume the leadership if the transition is not successful. Accordingly, there is significant uncertainty regarding the policies, actions and initiatives that North Korea might pursue in the future, as North Korea has recently announced its plan to test long-distance missiles, Kwang-myong Sung No. 3, despite the sanction from the United Nations Security Council and objection from the international society including the Nuclear Security Summit which was held in Seoul on March 22 and 23, 2012.

Furthermore, there have been recent military conflicts on the Korean peninsula. On March 26, 2010, the *Cheonan*, a Korean navy ship, sank off the western coast of Korea killing 46 soldiers. An investigation carried out by the Joint Civilian-Military Investigation Group, consisting of investigators from Korea, the United States, Australia, the United Kingdom and Sweden, concluded that the *Cheonan* was sunk by a North Korean torpedo. Also, on November 23, 2010, the North Korean military fired artillery shells onto the Korean island of Yeonpyeong, killing two Korean soldiers and two civilians which set off an exchange of fire between the two sides. Around the end of 2010, the International Criminal Court tentatively concluded that North Korea's sinking of the *Cheonan* and shelling of the island of Yeonpyeong constituted a war crime, and launched a preliminary investigation regarding such incidents.

On August 22, 2011, North Korea unilaterally declared that it will legally dispose of all Korean-owned real estate, equipment and raw materials it seized in April 2010 within the Mt. Geumgang resort area (the "Geumgang area"), concurrent with its seizure and embargo of Korean supplies and assets and its exit order of all employees who were dispatched from Korea (the "2011 Declaration"). It is estimated that the value of the assets, including the real estate, owned by the Government, the Korea Tourism Organization and other private Korean companies in the Geumgang area amount to approximately (Won)484 billion. Tourism in the Geumgang area has effectively been discontinued since a Korean tourist was shot and killed by a North Korean soldier on July 11, 2008. Currently, the Government is in the process of considering various options, including legal and diplomatic measures, in response to the 2011 Declaration. On April 13, 2012, North Korea launched a long-range rocket over the Yellow Sea. Korea, Japan and the United States condemned the launch.

There can be no assurance that the level of tension and instability in the Korean peninsula will not escalate in the future, or that the political regime in North Korea may not suddenly collapse. Any further increase in tension or uncertainty relating to the military, political or economic stability in the Korean peninsula, including a breakdown

of diplomatic negotiations over the North Korean nuclear program, occurrence of military hostilities, heightened concerns about the stability of North Korea's political leadership, a leadership crisis or a breakdown of high-level contacts, could have a material adverse effect on our business, financial condition and results of operations and could lead to a decline in the market value 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 20,216,314. 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 (Won)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 (Won)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.

***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 Korean 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 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 Dollars, subject to certain conditions. Accordingly, fluctuations in the exchange rate between the Won and the 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 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.

***Holders of American depositary shares may be required to pay a Korean securities transaction tax upon withdrawal of underlying common shares or the transfer of American depositary shares.***

Under Korean tax law, a securities transaction tax (including an agriculture and fishery special surtax) is imposed on transfers of shares listed on the Korea Exchange, including our common shares, at the rate of 0.3% of the sales price if traded on the Korea Exchange. According to a tax ruling issued by Korean tax authorities, securities transaction tax could be imposed on the transfer of American depositary shares. In May 2007, the Seoul Administrative Court held that depositary receipts do not constitute share certificates subject to the securities transaction tax. The case was upheld by the Seoul High Court, and the Supreme Court in 2008 dismissed the tax authorities' appeal against the Seoul High Court decision, rendering the Seoul High Court's decision final. However, having dismissed the tax authorities' appeal without ruling on the substantive law, it is unclear how much precedential value the Supreme Court's ruling will have on this subject. Even if depositary receipts, including the ADSs, constitute share certificates subject to securities transaction tax under the Securities Transaction Tax Law, capital gains from a transfer of depositary receipts listed on the New York Stock Exchange, the NASDAQ National Market or other qualified foreign exchanges are exempt from the securities transaction tax. See "Item 10.E. Taxation – Korean Taxation."

#### **Other Risks**

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

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

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

We are a corporation with limited liability organized under the laws of Korea. Substantially all of our directors and officers and other persons named in this annual report reside in Korea, and all or a significant portion of the assets of our directors and officers and other persons named in this annual report and substantially