SHINHAN FINANCIAL GROUP CO LTD
Form 20-F
April 30, 2018
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As filed with the Securities and Exchange Commission on April 30, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 20-F

(Mark One)

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

OR

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

For the fiscal year ended December 31, 2017

OR

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

For the transition period from __________ to __________

OR

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

Date of event requiring this shell company report

Commission File Number: 001-31798

Shinhan Financial Group Co., Ltd.

(Exact name of registrant as specified in its charter)

N/A	**The Republic of Korea**
(Translation of registrant s name into English)	**(Jurisdiction of incorporation or organization)**

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

Seoul 04513, Korea

(Address of principal executive offices)

Yu Sunghun, +822 6360 3071(T), irshy@shinhan.com, +822 6360 3098 (F), 20, Sejong-daero 9-gil, Jung-gu, Seoul 04513, Korea

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

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

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

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

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

None

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

None

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

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

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, and emerging growth company in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Emerging growth company

If an emerging growth company that prepares its financial statements in accordance with U.S. GAAP, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

The term new or revised financial accounting standard refers to any update issued by the Financial Accounting Standards Board to its Accounting Standards Codification after April 5, 2012.

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

U.S. GAAP	International Financial Reporting Standards as issued by the International Accounting Standards Board	Other

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

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

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

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

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CERTAIN DEFINED TERMS, CONVENTIONS AND CURRENCY OF PRESENTATION

Unless otherwise specified or the context otherwise requires:

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

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

All references to Korea or the Republic contained in this annual report are to the Republic of Korea. All references to the Government are to the government of the Republic of Korea. References to the Financial Services Commission are to the Financial Services Commission of Korea, and references to the Financial Supervisory Service are to the Financial Supervisory Service of Korea, the executive body of the Financial Services Commission.

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

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

In this annual report, unless otherwise indicated, all references to Won ~~or~~ W are to the currency of the Republic of Korea, and all references to U.S. Dollars, Dollars, $ or US$ are to the currency of the United States of America. Unless otherwise indicated, all translations from Won to Dollars were made at ₩1,067.4 to US$1.00, which was the noon buying rate in the City of New York on December 29, 2017 for cable transfers according to the H.10 statistical release of the Federal Reserve Board (the Noon Buying Rate). On April 13, 2018, the Noon Buying Rate was ₩1,070.6 to US$1.00. The Noon Buying Rate has been volatile recently and the U.S. Dollar amounts referred to in this report should not be relied upon as an accurate reflection of our results of operations. We expect this volatility to continue in the near future. No representation is made that the Won or U.S. Dollar amounts referred to in this report could have been or could be converted into Dollars or Won, as the case may be, at any particular rate or at all.

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

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

FORWARD LOOKING STATEMENTS

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

Although we believe that the expectations reflected in the forward-looking statements are reasonable, we can give no assurance that such expectations will prove to be correct. All forward-looking statements are management s present expectations of future events and are subject to a number of factors and uncertainties that

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

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

Not applicable.

ITEM 2. *OFFER STATISTICS AND EXPECTED TIMETABLE*

Not applicable.

ITEM 3. *KEY INFORMATION*

ITEM 3.A. Selected Financial Data

The selected consolidated income statement and balance sheet data set forth below for the years ended December 31, 2013, 2014, 2015, 2016 and 2017 have been derived from our consolidated financial statements which have been prepared in accordance with IFRS as issued by the IASB. Our consolidated financial statements as of and for the years ended December 31, 2013, 2014, 2015, 2016 and 2017 have been audited by independent registered public accounting firm KPMG Samjong Accounting Corp.

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

Consolidated Income Statement Data

	Year Ended December 31,					
	2013	**2014**	**2015**	**2016**	**2017**	**2017[1]**
	(In billions of Won and millions of US$, except per common share data)					
Interest income	₩ 12,591	₩ 12,061	₩ 11,130	₩ 11,236	₩ 11,799	$ 11,054
Interest expense	(5,986)	(5,271)	(4,437)	(4,031)	(3,956)	(3,706)
Net interest income	**6,605**	**6,790**	**6,693**	**7,205**	**7,843**	**7,348**
Fees and commission income	3,490	3,561	3,897	3,804	4,045	3,790
Fees and commission expense	(2,103)	(2,091)	(2,276)	(2,238)	(2,334)	(2,187)
Net fees and commission income	**1,387**	**1,469**	**1,621**	**1,566**	**1,711**	**1,603**
Net insurance loss	(383)	(413)	(432)	(419)	(460)	(431)
Dividend income	156	176	308	282	257	241
Net trading income (loss)	75	262	(344)	370	963	902
Net foreign currency transaction gain	296	224	78	462	364	341
Net gain (loss) on financial instruments designated at fair value through profit or loss	(122)	(361)	460	(502)	(1,060)	(993)
	701	681	772	648	499	468

Net gain on sale of available-for-sale financial assets						
Impairment losses on financial assets	(1,340)	(1,174)	(1,264)	(1,196)	(1,015)	(951)
General and administrative expenses	(4,203)	(4,463)	(4,475)	(4,509)	(4,811)	(4,507)
Net other operating expenses	(540)	(536)	(444)	(798)	(462)	(434)
Operating income	**2,632**	**2,655**	**2,973**	**3,109**	**3,829**	**3,587**
Equity method income	7	31	21	10	20	19
Other non-operating income (loss), net	37	182	147	52	(53)	(49)
Profit before income taxes	**2,676**	**2,868**	**3,141**	**3,171**	**3,796**	**3,557**
Income tax expense	(621)	(668)	(695)	(346)	(848)	(795)
Profit for the year	**₩ 2,055**	**₩ 2,200**	**₩ 2,446**	**₩ 2,825**	**₩ 2,948**	**$ 2,762**

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	Year Ended December 31,					
	2013	**2014**	**2015**	**2016**	**2017**	**2017[(1)]**
	(In billions of Won and millions of US$, except per common share data)					
Other comprehensive income (loss) for the year, net of income tax						
Items that are or may be reclassified to profit or loss:						
Foreign currency translation adjustments for foreign operations	₩ (58)	₩ (13)	₩ (6)	₩ 12	₩ (194)	$ (182)
Net change in unrealized fair value of available-for-sale financial assets	(269)	136	(266)	(434)	(323)	(303)
Equity in other comprehensive income (loss) of associates	(5)	6	12	3	(23)	(21)
Net change in unrealized fair value of cash flow hedges	6	(16)	3	(1)	16	15
Other comprehensive income (loss) of separate account	(2)	6	2	(4)	(9)	(9)
	(328)	119	(255)	(424)	(533)	(500)
Items that will never be reclassified to profit or loss:						
Remeasurements of defined benefit liability	19	(154)	(82)	15	103	97
Equity in other comprehensive income (loss) of associates					1	1
	19	(154)	(82)	15	104	98
Total other comprehensive loss, net of income tax	(309)	(36)	(337)	(409)	(429)	(402)
Total comprehensive income for the year	**₩ 1,746**	**₩ 2,164**	**₩ 2,109**	**₩ 2,416**	**₩ 2,519**	**$ 2,360**
Net income attributable to:						
Equity holders of the Group	₩ 1,898	₩ 2,081	₩ 2,367	₩ 2,775	₩ 2,918	$ 2,733
Non-controlling interest	157	119	79	50	30	29
Total comprehensive income attributable to:						
Equity holders of the Group	1,591	2,046	2,034	2,367	2,490	2,333
Non-controlling interest	155	118	75	49	29	27
Earnings per share:						
Basic earnings per share in Won and US$[(2)]	3,810	4,195	4,789	5,736	6,116	5.73
Dilutive earnings per share in Won and US$[(3)]	3,810	4,195	4,789	5,736	6,116	5.73

Notes:

(1) Won amounts are expressed in U.S. Dollar at the rate of ₩1,067.4 to US$1.00, the Noon Buying Rate in effect on December 29, 2017 for the convenience of readers. No representation is made that the Won or U.S. Dollar amounts referred to above could have been or could be converted into U.S. Dollars or Won, as the case may be, at any particular rate or at all.

(2) Basic earnings per share are calculated by dividing net income available to holders of our common shares by the weighted average number of common shares issued and outstanding for the relevant period.

(3) Dilutive earnings per share are calculated in a manner consistent with basic earnings per share, while giving effect to the potential dilution that could occur if convertible securities, options or other contracts to issue common shares were converted into or exercised for common shares. Common shares issuable upon conversion of redeemable convertible preferred shares are potentially dilutive.

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Consolidated Balance Sheet Data

	2013	2014	2015	2016	2017	2017[1]
	(In billions of Won and millions of US$, except per common share data)					
Assets						
Cash and due from banks	₩ 16,473	₩ 20,585	₩ 22,024	₩ 19,181	₩ 22,669	$ 21,237
Trading assets	18,033	24,362	22,638	26,696	28,464	26,667
Financial assets designated at fair value through profit or loss	3,361	2,737	3,244	3,416	3,579	3,353
Derivative assets	1,717	1,568	1,995	3,003	3,400	3,185
Loans, net	205,723	221,618	246,441	259,011	275,566	258,165
Available-for-sale financial assets	33,597	31,418	33,966	37,663	42,117	39,458
Held-to-maturity financial assets	11,031	13,373	16,192	19,805	24,991	23,413
Property and equipment, net	3,214	3,147	3,055	3,146	3,022	2,831
Intangible assets, net	4,226	4,153	4,266	4,227	4,272	4,002
Investments in associates	329	342	393	354	631	591
Current tax receivable	6	11	10	13	25	23
Deferred tax assets	196	228	164	641	592	555
Investment properties, net	690	268	209	353	418	392
Other assets, net	12,451	14,203	15,947	18,167	16,552	15,508
Assets held for sale	243	9	4	4	8	7
Total assets	**₩ 311,290**	**₩ 338,022**	**₩ 370,548**	**₩ 395,680**	**₩ 426,306**	**$ 399,387**
Liabilities						
Deposits	₩ 178,810	₩ 193,710	₩ 217,676	₩ 235,138	₩ 249,419	$ 233,670
Trading liabilities	1,258	2,689	2,135	1,977	1,848	1,732
Financial liabilities designated at fair value through profit or loss	5,909	8,996	8,916	9,234	8,298	7,774
Derivative liabilities	2,019	1,718	2,599	3,528	3,488	3,267
Borrowings	20,143	22,974	21,734	25,294	27,587	25,845
Debt securities issued	37,491	37,335	41,221	44,327	51,341	48,099
Liability for defined benefit obligations	118	309	226	131	7	7
Provisions	750	694	699	729	429	402
Current tax payable	239	257	142	273	349	327
Deferred tax liabilities	15	10	16	11	10	9
Liabilities under insurance contracts	15,662	17,776	20,058	22,377	24,515	22,967
Other liabilities	19,021	21,040	23,313	20,916	25,312	23,714
Total liabilities	**₩ 281,435**	**₩ 307,507**	**₩ 338,735**	**₩ 363,935**	**₩ 392,603**	**$ 367,813**

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	2013	2014	2015	2016	2017	2017(1)
	(In billions of Won and millions of US$, except per common share data)					
Equity						
Capital stock	₩ 2,645	₩ 2,645	₩ 2,645	₩ 2,645	₩ 2,645	$ 2,478
Hybrid bond	537	537	737	498	424	397
Capital surplus	9,887	9,887	9,887	9,887	9,887	9,263
Capital adjustments	(393)	(393)	(424)	(458)	(398)	(373)
Accumulated other comprehensive income	673	638	305	(102)	(530)	(496)
Retained earnings	14,189	15,869	17,690	18,640	20,791	19,478
Total equity attributable to equity holders of the Group	27,538	29,184	30,840	31,110	32,819	30,747
Non-controlling interest	2,317	1,331	973	635	884	827
Total equity	**₩ 29,855**	**₩ 30,515**	**₩ 31,813**	**₩ 31,745**	**₩ 33,703**	**$ 31,574**
Total liabilities and equity	**₩ 311,290**	**₩ 338,022**	**₩ 370,548**	**₩ 395,680**	**₩ 426,306**	**$ 399,387**

Note:

(1) Won amounts are expressed in U.S. Dollar at the rate of ₩1,067.4 to US$1.00, the Noon Buying Rate in effect on December 29, 2017 for the convenience of readers. No representation is made that the Won or U.S. Dollar amounts referred to above could have been or could be converted into U.S. Dollars or Won, as the case may be, at any particular rate or at all.

Dividends

	Year Ended December 31,				
	2013	2014	2015	2016	2017
	(In Won and US$)				
Cash dividends per share of common stock:					
In Korean Won	₩ 650	₩ 950	₩ 1,200	₩ 1,450	₩ 1,450
In U.S. Dollars(1)	$ 0.62	$ 0.87	$ 1.03	$ 1.20	$ 1.36
Cash dividends per share of preferred stock:					
In Korean Won	₩ 5,580	₩ 5,580	₩ 5,580	₩ N/A	₩ N/A
In U.S. Dollars(1)	$ 5.29	$ 5.12	$ 4.77	$ N/A	$ N/A

Note:

(1) Won amounts for 2013, 2014, 2015, 2016 and 2017 are expressed in U.S. Dollar at the rate of ₩1,055.3, ₩1,090.9, ₩1,169.3, ₩1,203.7 and ₩1,067.4, respectively, to US$1.00, the Noon Buying Rate in effect on December 31, 2013, 2014, 2015, 2016 and 2017, respectively, for the convenience of readers. No representation is made that the Won or U.S. Dollar amounts referred to above could have been or could be converted into U.S. Dollars or Won, as the case may be, at any particular rate or at all.

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Selected Statistical Information

Profitability Ratios and Other Data

	Year Ended December 31,				
	2013	2014	2015	2016	2017
	(Percentages)				
Net income attributable to the Group as a percentage of:					
Average total assets[1]	0.66%	0.68%	0.69%	0.73%	0.72%
Average total Group stockholders equity[1]	7.03	7.25	7.87	8.97	8.94
Dividend payout ratio[2]	19.47	24.66	27.21	25.62	23.92
Net interest spread[3]	1.95	1.93	1.78	1.83	1.94
Net interest margin[4]	2.36	2.31	2.08	2.06	2.13
Efficiency ratio[5]	88.25	87.31	88.15	88.73	89.04
Cost-to-income ratio[6]	52.41	55.32	52.74	51.34	52.39
Cost-to-average assets ratio[1][7]	6.48	6.09	6.56	6.45	7.48
Equity to average asset ratio[1][8]	9.43	9.36	8.72	8.14	8.00

Notes:

(1) Average total assets (including average interest-earning assets), liabilities (including average interest-bearing liabilities) and stockholder s equity are based on (a) daily balances for Shinhan Bank and (b) quarterly balances for other subsidiaries.

(2) Represents the ratio of total dividends declared on common and preferred stock and hybrid bonds as a percentage of net income attributable to the Group.

(3) Represents the difference between the yield on average interest-earning assets and the cost of average interest-bearing liabilities.

(4) Represents the ratio of net interest income to average interest-earning assets.

(5) Represents the ratio of non-interest expense to the sum of net interest income and non-interest income. Efficiency ratio is used as a measure of efficiency for banks and financial institutions. Efficiency ratio may be reconciled to comparable line items in our income statements for the periods indicated as follows:

	Year Ended December 31,				
	2013	2014	2015	2016	2017
	(In billions of Won, except percentages)				
Non-interest expense (A)	₩ 20,100	₩ 19,733	₩ 23,368	₩ 24,957	₩ 30,831
Divided by					
The sum of net interest income and non-interest income (B)	22,776	22,601	26,509	28,127	34,627
Net interest income	6,605	6,790	6,693	7,205	7,843

Non-interest income	16,171	15,811	19,816	20,922	26,784
Efficiency ratio ((A) as a percentage of (B))	88.25%	87.31%	88.15%	88.73%	89.04%

(6) Represents the ratio of general and administrative expenses to the sum of net interest income, net fee and commission income, net gain on financial assets and liabilities at fair value through profit or loss and net other operating income.

(7) Represents the ratio of non-interest expense to average total assets.

(8) Represents the ratio of average stockholders equity to average total assets.

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Asset Quality Ratios

	As of December 31,				
	2013	2014	2015	2016	2017
	(In billions of Won, except percentages)				
Total gross loans	₩ 207,987	₩ 223,879	₩ 248,429	₩ 261,004	₩ 277,489
Total allowance for loan losses	₩ 2,476	₩ 2,501	₩ 2,318	₩ 2,361	₩ 2,311
Allowance for loan losses as a percentage of total loans	1.19%	1.12%	0.93%	0.90%	0.83%
Impaired loans(1)	₩ 2,386	₩ 2,127	₩ 1,902	₩ 1,804	₩ 1,793
Impaired loans as a percentage of total loans	1.15%	0.95%	0.77%	0.69%	0.65%
Allowance as a percentage of impaired loans	103.77%	117.58%	121.87%	130.88%	128.89%
Total non-performing loans(2)	₩ 1,197	₩ 1,286	₩ 1,333	₩ 1,174	₩ 1,075
Non-performing loans as a percentage of total loans	0.58%	0.57%	0.54%	0.45%	0.39%
Allowance as a percentage of total assets	0.80%	0.74%	0.63%	0.60%	0.54%

Notes:

(1) Impaired loans include (i) loans for which the borrower has defaulted under Basel standards applicable during the relevant period and (ii) loans that qualify as troubled debt restructurings applicable during the relevant period.

(2) Non-performing loans are defined as loans, whether corporate or retail, that are past due more than 90 days.

Capital Ratios

	As of December 31,				
	2013	2014	2015	2016	2017
	(Percentages)				
Group BIS ratio(1)	13.43%	13.05%	13.39%	15.00%	14.78%
Total capital adequacy ratio of Shinhan Bank	16.29	15.43	14.75	15.70	15.59
Adjusted equity capital ratio of Shinhan Card(2)	30.41	29.69	28.88	26.23	24.52
Solvency ratio for Shinhan Life Insurance(3)	253.06	230.69	204.19	178.28	175.41

Notes:

(1)

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

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

(3) Solvency ratio is the ratio of the solvency margin to the standard amount of solvency margin as defined and computed in accordance with the guidelines issued by the Financial Services Commission for life insurance companies. Under these guidelines, Shinhan Life Insurance is required to maintain a minimum solvency ratio of 100%. See Item 4.B. Business Overview Supervision and Regulation Principal Regulations Applicable to Insurance Companies Capital Adequacy.

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

	As of December 31,		
	2015	2016	2017
	(In millions of Won, except percentages)		
Risk-weighted assets	₩ 203,274,542	₩ 198,642,643	₩ 207,768,636
Total risk-adjusted capital	₩ 27,216,448	₩ 29,786,515	₩ 30,713,464
Tier I capital	₩ 23,194,191	₩ 26,210,420	₩ 27,672,892
Tier I common equity capital	₩ 21,882,816	₩ 25,325,054	₩ 26,756,509
Capital adequacy ratio (%)	13.39%	15.00%	14.78%
Tier I capital adequacy ratio (%)	11.41%	13.19%	13.32%
Common equity capital adequacy ratio (%)	10.77%	12.75%	12.88%

Exchange Rates

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

Year Ended December 31,	At End of Period	Average(1)	High	Low
		(Won per US$1.00)		
2013	1,055.3	1,094.6	1,161.3	1,050.1
2014	1,090.9	1,054.0	1,117.7	1,008.9
2015	1,169.3	1,133.7	1,196.4	1,063.0
2016	1,203.7	1,160.5	1,242.6	1,090.3
2017	1,067.4	1,141.6	1,207.2	1,067.4
October	1,115.7	1,130.9	1,146.5	1,115.7
November	1,084.8	1,099.8	1,120.0	1,079.3
December	1,067.4	1,082.9	1,094.6	1,067.4
2018 (through April 13)	1,070.6	1,070.1	1,093.0	1,054.6
January	1,068.3	1,065.6	1,073.6	1,057.6
February	1,082.1	1,078.5	1,093.0	1,065.3
March	1,061.0	1,069.9	1,081.3	1,060.3
April (through April 13)	1,070.6	1,063.9	1,070.6	1,054.6

Source: Federal Reserve Board

Note:

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

We have translated certain amounts in Korean Won, which appear in this annual report, into U.S. Dollars for convenience. This does not mean that the Won amounts referred to could have been, or could be, converted into U.S. Dollars at any particular rate, the rates stated above, or at all. Unless otherwise stated, translations of Won amounts to U.S. Dollars are based on the Noon Buying Rate in effect on December 29, 2017, which was ₩1,067.4 to US$1.00. On April 13, 2018, the Noon Buying Rate in effect was ₩1,070.6 to US$1.00.

ITEM 3.B. Capitalization and Indebtedness

Not applicable.

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

Not applicable.

ITEM 3.D. Risk Factors

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

Risks Relating to Our Overall Business

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

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

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

In particular, difficulties in financial and economic conditions could result in significant deterioration in the quality of our assets and accumulation of higher provisioning, allowances for loan losses and charge-offs as an increasing number of our corporate and retail customers declare bankruptcy or insolvency or otherwise face increasing difficulties in meeting their debt obligations. For example, in 2011 and 2012, the continuing slump in the real estate market and the shipbuilding industry led to increased delinquency among our corporate borrowers in the construction, real estate leasing, shipbuilding and shipping industries, and in certain cases, even insolvency, workouts, recovery proceedings and/or voluntary arrangements with creditors, as was the case for the current and former member companies of the STX Group, Keangnam Enterprises Co., Ltd., Dongbu Steel Co., Ltd., Sambu Construction Co., Ltd. and Hanjin Heavy Industries & Construction Co., Ltd. During the same period, the sustained slump in the real estate market also led to increased delinquency among our retail borrowers, and in particular, borrowers with collective loans for pre-sale of newly constructed apartment units.

Accordingly, Shinhan Bank s delinquency ratio (based on delinquency of one or more month and net of charge-offs and loan sales) increased from 0.48% as of December 31, 2010 to 0.60% as of December 31, 2011 and 0.61% as of December 31, 2012. However, primarily due to a modest rebound in the housing market and Shinhan Bank s active efforts to reduce its exposure to such troubled industries and other at-risk borrowers through preemptive risk management policies and increased lending to borrowers with high-quality credit profiles as part of Shinhan Bank s strategic initiative to improve its asset quality, Shinhan Bank s delinquency ratio decreased to 0.39% as of December 31, 2013 and 0.31% as of December 31, 2014, remained stable at 0.33% as of December 31, 2015 and further decreased to 0.28% as of December 31, 2016 and 0.23% as of December 31, 2017. There is no assurance, however, that Shinhan Bank will not experience further loan losses from borrowers in the troubled industries since the quality of loans to such borrowers may further deteriorate due to the continued slump in these industries or for other reasons. As for Shinhan Card, its delinquency ratio under the Financial Services Commission guidelines decreased from 2.64% as of December 31, 2012 to 2.15%, 2.18%, 1.69%, 1.68% and 1.49% as of December 31, 2013, 2014, 2015, 2016 and 2017, respectively, largely as a result of its enhanced preemptive risk management and controlled asset growth as well as the sale of large non-performing loans to improve its asset quality.

Moreover, as was the case during the global financial crisis of 2008-2009, depending on the nature of the difficulties in the financial markets and general economy, we may be forced to scale back certain of our core lending activities and other operations and/or borrow money at a higher funding cost or face a tightening in the net interest spread, any of which may have a negative impact on our earnings and profitability. Furthermore, while we and our principal subsidiaries currently maintain a capital adequacy ratio at a level higher than the required regulatory minimum, there is no guarantee that an even higher capital requirement will not be imposed by the Government in case of a renewed economic crisis.

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

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

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

In the banking sector, Shinhan Bank competes principally with other national commercial banks in Korea, but also faces competition from a number of additional banking institutions, including branches and subsidiaries of foreign banks operating in Korea, regional banks, government-owned development banks and Korea s specialized banks, such as Korea Development Bank, Industrial Bank of Korea and the National Federation of Fisheries Cooperatives, 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, 2017, Korea had six major nationwide domestic commercial banks (including Citibank Korea Inc. and Standard Chartered Bank Korea Limited, both of which are domestic commercial banks acquired by global financial institutions), six regional commercial banks and branches and subsidiaries of 38 foreign banks. Foreign financial institutions, many of which have greater experiences and resources than we do, may continue to enter the Korean market and compete with us in providing financial products and services either by themselves or in partnership with existing Korean financial institutions.

In the small- and medium-sized enterprise and retail banking segments, which have been Shinhan Bank s traditional core businesses, competition is expected to increase further. In recent years, Korean banks, including Shinhan Bank, have increasingly focused on stable asset growth based on quality credit, such as corporate borrowers with high credit ratings, loans to small office, home office (SOHO) with high levels of collateralization, and mortgage and home equity loans within the limits of the prescribed loan-to-value ratios and debt-to-income ratios. This common shift in focus toward stable growth based on less risky assets has intensified competition as banks compete for the same limited pool of quality credit by engaging in price competition or by other means, although Shinhan Bank has traditionally focused, and will continue to focus, on enhancing profitability rather than increasing asset size or market share, and has avoided, to the extent practicable, engaging in price competition by way of lowering lending rates. In addition, such competition may result in lower net interest margin and reduced overall profitability, especially if the low interest rate environment were to continue for a significant period of time. Although net interest margin may improve if the base interest rate is increased during 2018, the effect on Shinhan Bank s results of operations may be less beneficial due to increased volatility of market interest rates and tighter regulations regarding SOHO loans, including the implementation of additional credit review guidelines for individual businesses. Therefore, if competing financial institutions seek to expand market share by lowering their lending rates, Shinhan Bank may suffer customer loss, especially among customers who select their lenders principally on the basis of lending rates. In response thereto or for other strategic reasons, Shinhan Bank may subsequently lower its lending rates to stay competitive, which could lead to a decrease in its net interest margins and outweigh any potential positive impact on the net interest margin from a general rise in market interest rates. Any future decline in Shinhan Bank s customer base or its net interest margins could have an adverse effect on our results of operations and financial condition.

In the credit card sector, Shinhan Card competes principally with existing monoline credit card companies, credit card divisions of commercial banks, consumer finance companies, other financial institutions and, recently, credit card service providers allied with mobile telecommunications service providers in Korea. Competition has been historically intense in this sector and the market has shown signs of saturation as existing and new credit card service providers make significant investments and engage in aggressive marketing campaigns and promotions to acquire new customers and target customers with high credit quality. While competition has subsided somewhat recently due to stricter government regulations, such as curbs on excessive marketing expenses, competition remains intense and credit card issuers may continue to compete with Shinhan Card for customers by offering lower interest rates and fees, higher credit limits, more attractive promotions and incentives and alternative products such as phone cards, gift cards and low-interest consumer loan products. As a result, Shinhan Card may lose customers or service opportunities to competing credit card issuers and/or incur higher marketing expenses. In addition, the Government regulations adopted in 2012 mandating lower merchant fees chargeable to small- and medium-sized enterprises (which are subject to revision every three years) and the Government guidelines issued in 2013 suggesting lower standard interest rates for cash advances and card loans have reduced, and are likely to continue to limit, the revenues of credit card companies, including Shinhan Card. Beginning January 31, 2016, a further reduction in the merchant fees chargeable to small- and medium-sized enterprises went into effect. In addition, due to the implementation of the Improper Solicitation and Graft Act on September 28, 2016, revenue growth for corporate cards and service related industries such as dining, floral and entertainment have shown signs of decline. In July 2017, the Enforcement Decree of the Specialized Credit Finance Business Act was amended to expand the range of small- and medium-sized enterprises subject to lower merchant fees. Additional regulations on loans reducing maximum interest rates chargeable from 27.9% to 24% came into effect in February 2018, placing further downward pressure on the results of operations for credit card companies for 2018 and beyond, and amendments to regulations requiring further downward adjustments to merchant fees are expected to continue in the near future. Furthermore, the Government s recent guidelines to bolster consumer protection and protect customers personal data in the aftermath of data leaks at certain credit companies (not including Shinhan Card) may result in additional compliance costs for Shinhan Card. Customer attrition, together with any further lowering of fees or reduction in base and market interest rates and/or additional expenses from more extensive marketing and promotional campaigns that Shinhan Card might implement to acquire and retain customers, could reduce its revenues and earnings. Furthermore, the average credit quality of Shinhan Card s customers may deteriorate if customers with higher credit quality borrow from our competitors rather than Shinhan Card and it may become more difficult for Shinhan Card to attract and maintain quality customers. In general, the growth, market share and profitability of Shinhan Card s operations may decline or become negative as a result of market saturation in this sector, interest rate competition, pressure to lower fee rates and incur higher marketing expenses, as well as Government regulation and social and economic developments in Korea that are beyond our control, such as changes in consumer confidence levels, spending patterns or public perception of credit card usage and consumer debt. If Shinhan Card fails to maintain or attract new cardholders or increase the card usage by existing customers or experiences deterioration in its asset quality and a rise in delinquency, our business, financial condition and results of operations may be adversely affected.

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

Consolidation among our rival institutions and the Government s privatization efforts may also add competition in the markets in which we and our subsidiaries conduct business. A number of significant mergers and acquisitions in the industry have taken place in Korea over the past decade, including the acquisition of Hanmi Bank by an affiliate of Citibank in 2004, Standard Chartered Bank s acquisition of Korea First Bank in 2005, Chohung Bank s merger with Shinhan Bank in 2006 and Hana Financial Group s acquisition of Korea Exchange Bank in 2012 and the resulting merger of Hana Bank and Korea Exchange Bank in September 2015. Moreover, in 2014, pursuant to the implementation of the Government s privatization plan with respect to Woori Finance Holdings (now merged into Woori Bank) and its former subsidiaries, Woori Financial, Woori Asset Management and Woori F&I were acquired by KB Financial Group, Kiwoom Securities and Daishin Securities, respectively, and Woori Investment & Securities, Woori Aviva Life Insurance and Woori FG Savings Bank were acquired by NongHyup Financial Group. In addition, in October 2014, the Government s ownership interest in the holding companies of Kwangju Bank and Kyongnam Bank were acquired by JB Financial Group and BS Financial Group (now BNK Financial Group), respectively. In 2015, the Government decided to sell a 30% to 40% interest in Woori Bank to multiple investors in separate blocks ranging from 4% to 10% each. Since December 2016, Korea Deposit Insurance Corporation has consummated sales transactions with seven institutional investors including Kiwoom Securities, Korea Investment and Securities, Hanwha Life Insurance, Tongyang Life Insurance, Eugene Asset Management, Mirae Asset Global Investments and IMM Private Equity for the sale of an aggregate 29.7% interest in Woori Bank in separate blocks. In the securities brokerage sector, Mirae Asset acquired KDB Daewoo Securities in 2016, creating the largest brokerage company in Korea by assets. On June 1, 2016, KB Financial Group completed its acquisition of Hyundai Securities and merged it with its existing brokerage unit, KB Investment & Securities Co, creating the fifth largest brokerage company in Korea by assets. Any of these developments may place us at a competitive disadvantage and outweigh any potential benefit to us in the form of opportunities to acquire new customers who are displeased with the level of services at the newly reorganized entities or to provide credit facilities to corporate customers who wish to maintain relationships with a wide range of banks in order to diversify their sources of funding. We expect that such consolidation and other structural changes in the financial industry will continue. Other financial institutions may seek to acquire or merge with other entities, and the financial institutions resulting from such consolidation may, by virtue of their increased size and business scope, provide greater competition for us. Increased competition and continuing consolidation may lead to decreased margins, resulting in a material adverse impact on our future profitability.

Regulatory reforms and the general modernization of business practices in Korea have also led to increased competition among financial institutions in Korea. Since July 2015, the Financial Services Commission has provided, through the Korea Financial Telecommunications and Clearings Institute, the integrated automatic payment transfer management service, which allows account holders to search for, terminate or modify automatic payments they have set up with financial institutions participating in such service (currently including banks, securities companies and other financial institutions such as The Post Office, Korean Federation of Community Credit Cooperatives, National Credit Union Federation of Korea, Mutual Savings Bank and National Forestry Cooperative Federation). In addition, the Financial Services Commission began providing the integrated account management service from December 2016, which allows account holders to search for detailed information of their bank accounts opened in banks participating in such service, close small-sum inactive accounts (i.e., accounts with no transaction activity during the previous one year period and with a balance of less than ₩500,000) and transfer the balance in such accounts to other accounts. Moreover, in December 2017, the Financial Services Commission introduced the my account at a glance system, which enables consumers to

view their key financial account information online, including information on banks, insurances, mutual finance, loan and card issuances on one page. The my account at a glance system is expected to become available on mobile channels and expand its scope of services to include savings banks and securities within 2018. Since their introduction, the integrated automatic payment transfer management and integrated account management services have gained widespread acceptance, evidenced by the fact that, as of September 30, 2017, these services have been used by approximately 17.6 million and 8.0 million users, respectively. As the reform of the financial sector continues, competition may become more intense among existing banks, insurance companies, securities companies and other financial organizations and may lead to significant changes in the current Korean financial market. As a result, Shinhan Bank may face difficulties in increasing or retaining its deposits, which in turn may result in an increase in its cost of funding and a decrease in its settlement and remittance service fee revenue.

Furthermore, as the Korean economy further develops and new business opportunities arise, more competitors may enter the financial services industry. For example, as online service providers and technology companies with large-scale user networks, such as Kakao Corp., NAVER and Samsung Electronics, recently make significant inroads in providing virtual payment services through a system based on a growing convergence of financial services and technology commonly referred to as fintech, competition for online customers is growing not just among commercial banks, but also from online and mobile payment service providers. Also, widespread consumer acceptance of mobile phone payment services in lieu of credit card services could add to the competitive threat faced by existing credit card service providers, including our credit card subsidiary. In 2015, the Government announced its plans to allow Internet-only banks to operate in Korea. KT consortium s K-Bank and Kakao consortium s Kakao Bank commenced operations in April 2017 and July 2017, respectively. Internet-only banks may have advantages over traditional banks as the former can pass savings in labor and overhead costs to their customers by offering higher interest rates on deposit accounts, lower loan costs and reduced service fees. Accordingly, commercial banks will likely face increasing pressure to upgrade their service platforms to attract and maintain online users, which represents a growing customer base compared to traditional customers who have primarily conducted banking in-person at physical banking branches.

Recently, following the global financial crisis, the Government has subjected Korean financial institutions to stricter regulatory requirements and guidelines in areas of asset quality, capital adequacy, liquidity and residential and other lending practices (including a requirement to maintain a certain ratio of core capital to total risk exposure, which was introduced in January 2018 in order to control excessive leverage), which has had a dampening effect on competition. The Financial Services Commission implemented the capital requirements of Basel III, whose minimum requirements were phased in sequentially from December 1, 2013 through full implementation by January 1, 2015, based on the guidelines set forth in the amended Regulation on the Supervision of the Banking Business and the Detailed Regulation on the Supervision of the Banking Business. In addition, the Financial Services Commission is currently implementing the Basel III requirements relating to liquidity coverage ratio and capital conservation buffer, each of which will be fully phased in by January 1, 2019. As of January 1, 2016, the Financial Services Commission implemented Basel III requirements relating to accumulation of additional capital for systemically important banks and bank holding companies and countercyclical capital buffer requirements. Each year, the Financial Services Commission may designate banks with significant influence (based on size and connectivity with other financial institutions) on the domestic financial system as a domestic systemically important bank and require the accumulation of additional capital in accordance with the highest of: (i) ratio of common equity capital to risk-weighted assets, ranging from 0.0% to 2.0%, depending on the systematic importance evaluation score, (ii) if the bank s holding company is a domestic systemically important bank holding company, the capital ratio corresponding to the additional capital required for the bank holding company under the Financial Holding Company Supervision Regulations, or (iii) if the bank is also a global systemically important bank, as defined by the Basel Committee on Banking Supervision (the Basel Committee), the capital ratio as required by the Basel Committee. According to the instructions of the Financial Services Commission, domestic systematically important banks including Shinhan Bank are required to maintain an additional capital buffer of 0.25% since January 1, 2016, with such buffer to increase by 0.25% annually to 1.00% by January 1, 2019. The Financial Services Commission may also, upon quarterly review, determine and require banks to accumulate a required level of countercyclical capital buffer within the range of

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0% to 2.5% of risk-weighted assets, taking into account factors such as the degree of increase in credit relative to the gross domestic product. However, there is no assurance that these measures will have the effect of curbing competition or that the Government will not reverse or reduce such measures or introduce other deregulatory measures, which may further intensify competition in the Korean financial services industry. For further details on the capital requirements applicable to us, see Item 4.B. Business Overview Supervision and Regulation Principal Regulations Applicable to Financial Holding Companies Capital Adequacy.

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

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

We and our subsidiaries in Korea are required to maintain specified capital adequacy ratios. For example, since January 1, 2015, we and our banking subsidiaries in Korea are required to maintain a minimum common equity Tier I capital adequacy ratio of 4.5%, a Tier I capital adequacy ratio of 6.0% and a total capital (BIS) ratio of 8.0%. These ratios measure the respective regulatory capital as a percentage of risk-weighted assets on a consolidated basis and are determined based on guidelines of the Financial Services Commission. In addition, as further described below, Shinhan Bank is also required to maintain a capital conservation buffer and additional capital as a domestic systemically important bank and may be required to maintain a countercyclical capital buffer. Also, our subsidiaries Shinhan Card, Shinhan Life Insurance and Shinhan Investment are each required to maintain a consolidated adjusted equity capital ratio of 8.0%, a solvency ratio of 100% and a net equity ratio of 100%, respectively.

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

In December 2010, the Basel Committee issued final rules in respect of (i) a global regulatory framework for more resilient banks and banking systems and (ii) an international framework for liquidity risk measurement, standards and monitoring, which together are commonly referred to as Basel III. Under Basel III, Tier I capital is defined to include common equity Tier I and additional Tier I capital. Common equity Tier I capital is a new category of capital primarily consisting of common stock, capital surplus, retained earnings and other comprehensive income (progressively phased into the capital ratio calculation over several years). The new minimum capital requirements, including the minimum common equity Tier I requirement of 4.5% and additional mandatory capital conservation buffer requirement of 2.5%, are currently being implemented in phases until January 1, 2019. Additional discretionary countercyclical capital buffer requirements are also expected to be phased in, which will range at the discretion of national regulators between 0% and 2.5% of risk-weighted assets. Basel III also introduces a minimum leverage ratio requirement. On December 7, 2017, the Basel Committee finalized several key methodologies for measuring risk-weighted assets. The revisions include a standardized approach for credit risk, standardized approach for operational risk, revisions to the credit valuation adjustment (CVA) risk framework and constraints on the use of internal models. The Basel Committee had also previously finalized a revised standardized model for counterparty credit risk, revisions to the securitization framework and its fundamental review of the trading book, which updates both modeled and standardized approaches for market risk measurement. The revisions also include a capital floor set at 72.5% of total risk-weighted assets based on the revised standardized approaches to limit the extent to which banks can reduce risk-weighted asset levels through the use of internal models.

In order to implement the capital requirements under Basel III in Korea, the Regulation on the Supervision of the Banking Business was amended, effective December 1, 2013. Under the amended Regulation on the Supervision of the Banking Business, effective from January 1, 2015, commercial banks in Korea are required to maintain a minimum common equity Tier I ratio of 4.5%, a minimum Tier I capital ratio of 6.0% and a minimum total capital (BIS) ratio of 8.0%. The Regulation on the Supervision of the Banking Business was further amended on December 26, 2014, to implement the liquidity coverage ratio requirements under Basel III in increments of 5% annually, from 80% as of January 1, 2015 to 100% as of January 1, 2019. Capital conservation buffer requirements are also being phased in from January 1, 2016 in increments of 0.625% annually, to the effect that commercial banks in Korea will be required to maintain a capital conservation buffer of 2.5% as of January 1, 2019. If a commercial bank fails to maintain such capital conservation buffer requirements, such bank will be subject to certain restrictions relating to its use of income, such as distributing dividends and purchasing treasury stock. As of January 1, 2016, the Financial Services Commission implemented Basel III requirements relating to accumulation of additional capital for systemically important banks and bank holding companies and countercyclical capital buffer requirements. Each year, the Financial Services Commission may designate banks with significant influence (based on size and connectivity with other financial institutions) on the domestic financial system as a domestic systemically important bank and require the accumulation of additional capital in accordance with the highest of: (i) ratio of common equity capital to risk-weighted assets, ranging from 0.0% to 2.0%, depending on the systematic importance evaluation score, (ii) if the bank s holding company is a domestic systemically important bank holding company, the capital ratio corresponding to the additional capital required for the bank holding company under the Financial Holding Company Supervision Regulations, or (iii) if the bank is also a global systemically important bank, as defined by the Basel Committee, the capital ratio as required by the Basel Committee. Shinhan Financial Group, Shinhan Bank and Jeju Bank were selected as a domestic systemically important bank holding company and domestic systemically important bank, respectively, for 2017. According to the instructions of the Financial Services Commission, domestic systematically important banks including the Bank are required to maintain an additional capital buffer of 0.25% since January 1, 2016, with such buffer to increase by 0.25% annually to 1.00% by January 1, 2019. The Financial Services Commission may also, upon quarterly review, determine and require banks to accumulate a required level of countercyclical capital buffer within the range of 0% to 2.5% of risk-weighted assets, taking into account factors such as the degree of increase in credit relative to the gross domestic product. Since March 2016, the Financial Services Commission has maintained countercyclical capital buffer requirements at 0%, and the Financial Supervisory Service is expected to maintain the countercyclical capital buffer requirement at 0% for the first quarter of 2018.

We and our banking subsidiaries are currently, and have been, in full compliance with Basel III requirements as implemented in Korea since its introduction in December 2013. However, there is no assurance that we will continue to be able to be in compliance with Basel III requirements. New requirements under Basel III may require an increase in the credit risk capital requirements in the future, which may require us or our subsidiaries to either improve asset quality or raise additional capital. In addition, if the capital adequacy ratios of us or our subsidiaries were to fall below the required levels, the Financial Services Commission might impose penalties ranging from a warning to suspension or revocation of our or our subsidiaries business licenses. In order to maintain the capital adequacy ratios above the required levels, we or our subsidiaries may be required to raise additional capital through equity financing, but there is no assurance that we or our subsidiaries will be able to do so on commercially favorable terms or at all and, even if successful, any such capital raising may have a dilutive effect on our shareholders with respect to their interest in us or on us with respect to our interest in our subsidiaries.

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

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

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

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

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

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

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

The most significant market risks we face are interest rate, foreign exchange and bond and equity price risks. Changes in interest rate levels, yield curves and spreads may affect the interest rate margin realized

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

Of particular importance is the change in the base and market interest rates. Since 2009, Korea, like many other countries, has experienced a low interest rate environment despite some marginal fluctuations, in part due to the Government s policy to stimulate the economy through active rate-lowering measures. Between 2009 and 2014, the base interest rate set by the Bank of Korea remained within the band between 2.00% and 3.25%. In an effort to support Korea s economy in light of the recent slowdown in Korea s growth and uncertain global economic prospects, the Bank of Korea reduced the base interest rate to 1.75% in March 2015, 1.50% in June 2015, and further reduced such rate to the historic low of 1.25% in June 2016. In November 2017, the Bank of Korea raised the base interest rate to 1.50%, marking the first time it has increased the base interest rate since 2011. Interest rate movements, in terms of magnitude and timing as well as their relative impact on our assets and liabilities, have a significant impact on our net interest margin and profitability, particularly with respect to our financial products that are sensitive to such movements. For example, if the interest rates applicable to our loans (which are recorded as assets) increase at a slower pace or by a thinner margin than the interest rates applicable to our deposits (which are recorded as liabilities), our net interest margin will shrink and our profitability will be negatively affected. In addition, the relative size and composition of our variable rate loans and deposits (as compared to our fixed rate loans and deposits) may also impact our net interest margin. Furthermore, the difference in the average term of our interest-earning assets (primarily loans) compared to our interest-bearing liabilities (primarily deposits) may also impact our net interest margin. For example, since our deposits tend to have longer terms, on average, than those of our loans, our deposits are on average less sensitive to movements in the base interest rates on which our deposits and loans tend to be pegged, and therefore, a decrease in the base interest rates tends to decrease our net interest margin while an increase in the base interest rates tends to have the opposite effect. While we continually manage our assets and liabilities to minimize our exposure to interest rate volatility, such efforts by us may not mitigate the impact of interest rate volatility in a timely or effective manner, and our net interest margin, and in turn our financial condition and results of operations, could suffer significantly.

We cannot assure you when and to what extent the Government will in the future adjust the base interest rate, to which the market interest rate correlates. A decision to adjust the base interest rate is subject to many policy considerations as well as market factors, including the general economic cycle, inflationary levels, interest rates in other economies and foreign currency exchange rates, among others. In general, a decrease in interest rates adversely affects our interest income due to the different maturity structure for our assets and liabilities as discussed above. In contrast, if there were to be a significant or sustained increase in interest rates, all else being equal, such movement would lead to a decline in the value of traded debt securities and could also raise our funding costs, while reducing loan demand, especially among retail customers. Rising interest rates may therefore require us to re-balance our assets and liabilities in order to minimize the risk of potential mismatches in our asset liability management and to maintain our profitability. In addition, rising interest rates may adversely affect the Korean economy and the financial condition of our corporate and retail borrowers, including holders of our credit cards, which in turn may lead to deterioration of asset quality for our credit portfolio. Since most of our retail and corporate loans bear interest at rates that adjust periodically based on prevailing market rates, a sustained increase in interest rates will increase the funding costs of our borrowers and may adversely affect their ability to make payments on their outstanding loans. See Item 5.A.

Operating Results Interest Rates.

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We may incur losses associated with our counterparty exposures.

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

Risks Relating to Our Banking Business

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

Our banking activities are conducted primarily through our wholly-owned subsidiary, Shinhan Bank. One of our core banking businesses has historically been and continues to be lending to small- and medium-sized enterprises (as defined in Item 4.B. Business Overview Our Principal Activities Corporate Banking Services Small- and Medium-sized Enterprises Banking). Our loans (before allowance for loan losses and deferred loan origination costs and fees) to such enterprises amounted to ₩67,336 billion as of December 31, 2015, ₩71,757 billion as of December 31, 2016 and ₩78,556 billion as of December 31, 2017, representing 27.1%, 27.5% and 28.3%, respectively, of our total loan portfolio as of such dates.

Compared to loans to large corporations, which tend to be better capitalized and better able to weather business downturns, or loans to individuals and households, which tend to be secured with homes and with respect to which the borrowers are therefore less willing to default, loans to small- and medium-sized enterprises have historically had a relatively higher delinquency ratio. Many small- and medium-sized enterprises represent sole proprietorships or small businesses dependent on a relatively limited number of suppliers or customers and tend to be affected to a greater extent than large corporate borrowers by fluctuations in the Korean and global economy. In addition, small- and medium-sized enterprises often maintain less sophisticated financial records than large corporate borrowers. Therefore, it is generally more difficult for banks to judge the level of risk inherent in lending to such enterprises, as compared to large corporations. In addition, many small- and medium-sized enterprises are dependent on business relationships with large corporations in Korea, primarily as suppliers. Any difficulties encountered by those large corporations would likely have not only an adverse effect on the liquidity and financial condition of related small- and medium-sized enterprises, including those to which we have exposure, but also result in an impairment of their ability to repay loans. As large Korean corporations continue to expand into China, Southeast Asia and other countries with lower labor costs and other expenses by relocating their production plants and facilities to such countries, such development may have a material adverse impact on such small- and medium-sized enterprises.

Financial difficulties experienced by small- and medium-sized enterprises as a result of, among other things, recent economic difficulties in Korea and globally and aggressive marketing and intense competition among banks to lend to this segment in recent years, coupled with our efforts to counter asset quality deterioration through conservative lending policy, have led to a fluctuation in the asset quality of our loans to this segment. As of December 31, 2015, 2016 and 2017, Shinhan Bank s delinquent loans to small- and medium-sized enterprises were ₩308 billion, ₩362 billion and ₩303 billion, respectively, representing delinquency ratios (net of charge-offs and loan sales) of 0.46%, 0.51%, 0.39% respectively. If the ongoing difficulties in the Korean or global economy were to continue or aggravate, the delinquency ratio for our loans to small- and medium-sized enterprises may rise.

Of particular concern is our significant exposure to enterprises in the real estate and leasing and construction industries. As of December 31, 2017, Shinhan Bank had outstanding loans (before allowance for loan losses and deferred loan origination costs and fees) to enterprises in the real estate and leasing and construction industries (many of which are small- and medium-sized enterprises) of ₩21,490 billion and ₩2,550 billion, respectively, representing 9.2% and 1.1%, respectively, of its total loan portfolio as of such date. We also have other exposure to borrowers in these sectors of the Korean economy, including extending guarantees for the benefit of such companies and holding debt and equity securities issued by such companies. In addition, Shinhan Bank has exposure to borrowers in the shipbuilding and shipping industries, which have yet to stage a meaningful turnaround.

The enterprises in the real estate development and construction industries in Korea, which are heavily concentrated in the housing market, continue to experience difficulties amid slowing real estate demand despite a moderate recovery in recent years, largely due to a combination of factors including the Government s policy measures to stabilize the real estate market, oversupply of residential property, ongoing economic sluggishness in Korea and globally and the demographic changes in the Korean population. We also have limited exposure to real estate project financing, particularly by construction companies that have built residential units in provinces outside the metropolitan Seoul area, which have experienced a relatively low rate of pre-sales, the proceeds from which the construction companies primarily rely on as a key source for liquidity and cash flow.

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

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, 2017, the secured portion of Shinhan Bank s loans (before allowance for loan losses and deferred loan origination costs and fees) amounted to ₩106,503 billion, representing 49.8% of its total loans. No assurance can be given that the collateral value will not materially decline in the future. Shinhan Bank s general policy for mortgage and home equity loans is to lend up to 40% to 70% of the appraised value of the collateral and to periodically re-appraise such collateral. However, if the real estate market in Korea experiences a downturn, the value of the collateral may fall below the outstanding principal balance of related mortgage loans. Borrowers of such under-collateralized mortgages or loans may be forced to pay back all or a portion of such mortgage loans or, if unable to meet the collateral requirement through such repayment, sell the underlying collateral, which sales may lead to a further decline in the price of real estate in general and set off a chain reaction for other borrowers due to the further decline in the value of collateral. Declines in real estate prices reduce the collateral values securing our mortgage and home equity loans, and such reductions in collateral values may result in our inability to cover the uncollectible portion of our secured loans. A decline in the value of the real estate or other collateral securing our loans, or our inability to obtain additional collateral in the event of such decline, may result in the deterioration of our asset quality and require us to make additional loan loss provisions. In Korea, foreclosure on collateral generally requires a written petition to a Korean court. Foreclosure procedures in Korea generally take 10 to 14 months from initiation to collection depending on the nature of the collateral, and foreclosure applications may be subject to delays and administrative requirements, which may result in a decrease in the recovery value of such collateral. No assurance can be given 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

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collateral and general declines in collateral value. Our failure to recover the expected value of collateral could expose us to significant losses.

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

Primarily through Shinhan Bank, we, alone or together with other financial institutions, provide financing to real estate development projects, which are concentrated largely in the construction of residential complexes. Developers in Korea commonly use project financing to acquire land and pay for related project development costs. As a market practice, lenders in project financing, including Shinhan Bank, generally receive from general contractors a performance guarantee for the completion of projects by the developers as well as a payment guarantee for the loans raised by a special purpose financing vehicle established by the developers in order to procure the construction orders, as the developers tend to be small and highly leveraged. As of December 31, 2017, the total outstanding amount of Shinhan Bank s real estate project financing-related exposure was ₩1.7 trillion, which represents a decrease over the years as Shinhan Bank has actively reduced new exposures in this area in light of the sustained downturn in the Korean real estate market. However, if defaults were to significantly increase under our existing loans to real estate development projects and the general contractors fail to pay the guaranteed amount necessary to cover the amount of our financings, this may have an adverse effect on our business, financial condition and results of operations.

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

Of Shinhan Bank s 10 largest corporate exposures as of December 31, 2017, two were companies for which Shinhan Bank was a main creditor bank. All of the 10 companies are or were members of the main debtor groups as identified by the Governor of the Financial Supervisory Service, which are mostly comprised of the largest Korean commercial conglomerates known as *chaebols*. As of such date, the total amount of Shinhan Bank s exposures to the 10 companies was ₩18,053 billion, or 11.5%, of its total exposures. As of that date, Shinhan Bank s single largest outstanding exposure to a main debtor group amounted to ₩4,328 billion, or 2.8%, of its total exposures. Largely due to the continued stagnation in the shipbuilding industry, current and former member companies of the STX Group, one of the leading conglomerates in Korea, entered into voluntary arrangements in 2013 with their creditors (including Shinhan Bank) to improve their credit situation, and STX Offshore & Shipbuilding and STX Heavy Industries, two of the STX Group s member companies, recently filed for court receivership in May 2016 and July 2016, respectively. Due to stagnation in the construction industry, Keangnam Enterprises Co., Ltd., a large construction company in Korea, also entered into workout proceedings in 2013 and subsequently filed for recovery proceedings in March 2015. Dongbu Steel Co., Ltd. and Sambu Construction Co., Ltd. also experienced significant hardship and entered into workout or recovery proceedings in 2015. Additionally, in October 2015, creditors of Daewoo Shipbuilding & Marine Engineering Co., Ltd., led by Korea Development Bank, announced a restructuring plan that included cash injection and additional loans totaling ₩4.2 trillion and extensive streamlining measures, and in November 2016, Korea Development Bank agreed to swap ₩1.8 trillion of debt to equity and the Export-Import Bank of Korea agreed to issue ₩1 trillion of perpetual bonds. Amidst continued deterioration of Daewoo Shipbuilding & Marine Engineering Co., Ltd. s financial conditions, in March 2017, Korea Development Bank and the Export-Import Bank of Korea further agreed to provide an additional ₩2.9 trillion in loans and swap ₩1.6 trillion of debt to equity, provided that other creditors and bondholders agree to certain debt-to-equity swaps and extension of maturities. In January 2016, Hanjin Heavy Industries & Construction Co., Ltd. entered into voluntary restructuring agreements with its creditors due to liquidity shortage in the wake of prolonged industry slowdown. As part of its active past efforts to reduce exposure to the shipbuilding and construction sectors, Shinhan Bank currently has limited exposure to the aforementioned troubled companies. However, if the credit quality of Shinhan Bank s exposure to large corporations, including those in the main debtor groups, declines, Shinhan Bank may be required to record additional loan loss provisions in respect of loans and impairment losses in respect of securities, which would adversely affect its financial condition, results of operations and capital adequacy. No assurance can be given that the allowances it has recognized against these exposures will be sufficient to cover all future losses arising from such exposures, especially in the case of a prolonged or renewed economic downturn.

A limited number of the main debtor groups to which Shinhan Bank has credit exposure are subject to restructuring programs or are otherwise making significant efforts to improve their financial conditions, such as by obtaining intragroup loans and entering into agreements for further improvement of their capital structures. No assurance can be given that there will not be future restructuring with Shinhan Bank s major corporate customers or that such restructuring will not result in significant losses to Shinhan Bank with less than full recovery. In addition, if the Government decides to pursue an aggressive restructuring policy with respect to distressed companies, Korean commercial banks, including Shinhan Bank, may face a temporary rise in delinquencies and intensified pressure for additional provisioning. Furthermore, bankruptcies or financial difficulties of large corporations, including *chaebol* groups, may have an adverse ripple effect of triggering delinquencies and impairment of Shinhan Bank s loans to small- and medium-sized enterprises that supply parts or labor to such corporations. If Shinhan Bank experiences future losses from its exposure to large corporations, including *chaebol* groups, it may have a material adverse effect on Shinhan Bank s busines