

SHINHAN FINANCIAL GROUP CO LTD

Form 20-F/A

October 12, 2007

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**As filed with the Securities and Exchange Commission on October 12, 2007**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
Form 20-F/A  
(Amendment No. 1)**

(Mark One)

- REGISTRATION STATEMENT PURSUANT TO SECTION 12(b) OR (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, 2006**  
**OR**
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from** \_\_\_\_\_ **to** \_\_\_\_\_  
**OR**
- SHELL COMPANY REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**Date of event requiring this shell company report**

**Commission File Number: 001-31798**

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

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

**N/A**

*(Translation of registrant's name into English)*

**The Republic of Korea**

*(Jurisdiction of incorporation or organization)*

**120, 2-Ga, Taepyung-Ro, Jung-Gu  
Seoul 100-102, Korea**

*(Address of principal executive offices)*

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

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

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

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

None

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

None

**Indicate the number of outstanding shares of each of the issuer's classes of capital or common stock as of the close of the last full fiscal year covered by this Annual Report:** 374,437,647 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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

**Indicate by check mark which 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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**EXPLANATORY NOTE**

This Amendment No. 1 to the registrant's annual report for the fiscal year ended December 31, 2006 (File No. 001-31798) (the Original Annual Report) is being filed solely for the purpose of correcting a typographical error in the Report of Independent Registered Public Accounting Firm included in the registrant's financial statements referred to in Item 8. Financial Information, Item 18 Financial Statements and Item 19 Exhibits, as set forth below:

on page F-2, the reference to our report dated June 13, 2007 in the last paragraph of the Report of Independent Registered Public Accounting Firm shall be changed to our report dated June 18, 2007.

This Amendment No. 1 does not reflect events occurring after the filing of the Original Annual Report and does not modify or update the disclosure therein in any way other than as required to reflect the amendments described herein and reflected below. No other changes have been made to the Original Annual Report. The filing of this Amendment No. 1 should not be understood to mean that any statements contained herein are true or complete as of any date subsequent to the date of the filing of the Original Annual Report.

**ITEM 8. FINANCIAL INFORMATION**

**CONSOLIDATED FINANCIAL STATEMENTS AND OTHER FINANCIAL INFORMATION**

**Consolidated Financial Statements**

Our consolidated financial statements are set forth under Item 18. Financial Statements.

**Dividend Policy**

See Item 10. Additional Information Articles of Incorporation Dividends. For a description of tax consequences of dividends paid to our shareholders, see Item 10. Additional Information Taxation Korean Taxation Dividends on Shares of Common Stock or American Depositary Shares and Item 10. Additional Information Taxation United States Taxation Distributions on Shares or American Depositary Receipts.

**Legal Proceedings**

In October 2001, the trustees of the TRA Rights Trust (as sole successor in interest to Seagate) instituted litigation against several defendants, including Shinhan Bank. The plaintiff argued that Shinhan Bank is jointly and severally liable for damages as it had actively participated in certain financing activities that contributed to the fraudulent inflation of the revenues, income and assets as reflected in the financial statements of L&H Korea, a principal subsidiary of Lernout & Hauspie (L&H). The plaintiff sought damages for the impact of the fraud on the price of L&H shares and, in particular, treble damages in the amount of approximately US\$167 million under Racketeer Influenced and Corrupt Organizations, one of its alleged causes of claim (Filler Case). In addition, in November 2001, Stonington Partners Inc., Stonington Capital Appreciation 1994 Fund L.P. and Stonington Holdings, L.L.C., the former shareholders of L&H, instituted litigation against several defendants, including Shinhan Bank, alleging the same causes of action against Shinhan Bank under the same operative facts as the above-described litigation. (Stonington Case) These plaintiffs sought compensatory damages for the impact of the fraud on the price of L&H shares, and punitive damages to be determined at trial. Alleging the same cause of action, Janet Baker, James Baker, JKBaker LLC and JMBaker LLC also instituted litigation against several defendants, including Shinhan Bank, in March 2002 (Baker Case). All of these cases have been decided by courts of relevant jurisdiction in favor of the defendant, and, as the relevant statutes of limitations have passed without further appeal by the plaintiffs, we believe that these lawsuits have been concluded. In August 2005, Scott L. Baena, as the trustee of L&H, also instituted litigation (the Baena Case) in the Southern District of New York against several defendants, including Shinhan Bank and Chohung Bank, alleging substantially the same causes of action against Shinhan Bank and Chohung Bank under the same operative facts as the Baker Case, the Filler Case and the Stonington Case for a damage claim of US\$50 million. No assurances can be given the court will rule in favor of the defendants in the Baena Case. While we are unable to predict the ultimate disposition of the foregoing claims, its ultimate disposition will not, in the opinion of management, have a material adverse effect on us. We believe that the transactions with L&H Korea were conducted in the ordinary course of our banking practices, where the transaction involved a customary secured lending without any financing for receivables. We intend to vigorously defend against any additional claims or appeals.

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Other than as discussed above, neither we nor any of our subsidiaries is involved in any material litigation, arbitration or administrative proceedings relating to claims which may have a significant effect on our financial condition or results of operations, including the financial condition or results of operations of Shinhan Bank or our other consolidated subsidiaries, and we are not aware of any such litigation, arbitration or administrative proceeding that is pending or threatened.

**ITEM 18. FINANCIAL STATEMENTS**

Reference is made to Item 19(a) for a list of all financial statements filed as part of this annual report.

**ITEM 19. EXHIBITS**

(a) Financial Statements filed as part of this Annual Report:

See Index to Financial Statements on page F-1 of this annual report.

(b) Exhibits filed as part of this Annual Report:

See Exhibit Index beginning on page E-1 of the Original Annual Report.

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**SIGNATURES**

The registrant hereby certifies that it meets all of the requirements for filing on Form 20-F and that it has duly caused and authorized the undersigned to sign this annual report on its behalf.

Date: October 12, 2007

Shinhan Financial Group Co, Ltd.

By: /s/ In Ho Lee

Name: In Ho Lee

Title: President & Chief Executive Officer

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**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders  
Shinhan Financial Group Co., Ltd.:

We have audited the accompanying consolidated balance sheets of Shinhan Financial Group Co., Ltd. and its subsidiaries (the Group) as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity, and cash flows for each of the years in the three-year period ended December 31, 2006. These consolidated financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Shinhan Financial Group Co., Ltd. and its subsidiaries as of December 31, 2006 and 2005, the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2006, in conformity with U.S. generally accepted accounting principles.

The accompanying consolidated financial statements as of and for the year ended December 31, 2006 have been translated into United States dollars solely for the convenience of the reader. We have audited the translation and, in our opinion, the consolidated financial statements expressed in Korean Won have been translated into dollars on the basis set forth in note 2 of the notes to the consolidated financial statements.

We have also audited, in accordance with the standards of Public Company Accounting Oversight Board (United States), the effectiveness of Shinhan Financial Group, Co., Ltd. and its subsidiaries' internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated June 18, 2007 expressed an unqualified opinion on management's assessment of, and the effective operation of, internal control over financial reporting.

/s/ KPMG Samjong Accounting Corp.

Seoul, Korea  
June 18, 2007

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM  
INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Board of Directors and Stockholders  
Shinhan Financial Group Co., Ltd.:

We have audited management's assessment, included in the accompanying Management's Annual Report on Internal Control over Financial Reporting in Item 15 of the accompanying Part I of Form 20-F that Shinhan Financial Group Co., Ltd. and its subsidiaries (the Group) maintained effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Group's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Group's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that Shinhan Financial Group, Co., Ltd. and its subsidiaries maintained effective internal control over financial reporting as of December 31, 2006, is fairly stated, in all material respects, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also, in our opinion, Shinhan Financial Group, Co., Ltd. and its subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2006, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Shinhan Financial Group, Co., Ltd. and its subsidiaries as of December 31, 2006 and 2005, and the related consolidated statements of income, changes in stockholders' equity and cash flows for

each of the years in the three-year period ended December 31, 2006, and our report dated June 18, 2007 expressed an unqualified opinion on those consolidated financial statements.

/s/ KPMG Samjong Accounting Corp.

Seoul, Korea  
June 18, 2007

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**Shinhan Financial Group Co., Ltd. and Subsidiaries**  
**Consolidated Balance Sheets**  
**December 31, 2005 and 2006**

	<b>2005</b>		<b>2006</b>		<b>2006</b>
	<b>(In millions of Korean Won, except share data)</b>				<b>(See Note 1) (In thousands of US\$, except share data)</b>
<b>Assets</b>					
Cash and cash equivalents	W	2,434,382	W	1,691,303	\$ 1,818,605
Restricted cash (Note 4)		3,643,767		6,758,043	7,266,713
Interest-bearing deposits		626,771		725,191	779,775
Call loans and securities purchased under resale agreements (Note 5)		1,499,438		1,243,059	1,336,623
Trading assets (Note 6)		4,507,043		4,836,892	5,200,959
Securities:					
Available-for-sale securities (Note 7)		22,479,721		17,458,399	18,772,472
Held-to-maturity securities (Note 7)		2,963,074		7,581,093	8,151,713
Loans (net of allowance for loan losses of W1,511,503 in 2005 and W1,575,013 in 2006) (Note 8)		104,446,954		120,989,101	130,095,808
Customers liability on acceptances		1,878,866		1,417,385	1,524,070
Premises and equipment, net (Note 9)		1,876,496		2,097,106	2,254,953
Intangible assets (Note 10)		1,834,881		1,590,239	1,709,934
Goodwill (Note 10)		1,122,605		993,320	1,068,086
Security deposits		1,077,658		1,107,603	1,190,971
Other assets (Notes 11, 25)		4,723,657		6,842,830	7,357,881
<b>Total Assets</b>	<b>W</b>	<b>155,115,313</b>	<b>W</b>	<b>175,331,564</b>	<b>\$ 188,528,563</b>

**Liabilities and Stockholders equity**

**Liabilities**

## Deposits:

Interest-bearing (Note 12)	W	83,278,197	W	91,578,301	\$ 98,471,291
Non-interest-bearing (Note 12)		3,143,170		3,918,153	4,213,068
Trading liabilities (Note 6)		1,048,157		1,610,840	1,732,086
Acceptances outstanding		1,878,866		1,417,385	1,524,070
Short-term borrowings (Note 13)		11,968,300		10,995,026	11,822,609
Secured borrowings (Note 14)		7,501,707		8,102,714	8,712,596
Long-term debt (Notes 15 and 22)		26,171,822		32,574,138	35,025,955
Future policy benefits (Note 16)		4,777,568		5,682,834	6,110,575
Accrued expenses and other liabilities (Notes 17, 25)		7,089,112		9,310,900	10,011,719

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Total Liabilities	W	146,856,899	W	165,190,291	\$	177,623,969
Commitments and contingencies (Note 31)						
Minority interest		79,758		161,935		174,124
Redeemable convertible preferred stock, W5,000 par value; 44,720,603 shares authorized; 22,360,301 shares issued and outstanding in 2005; 0 shares issued and outstanding in 2006 (Note 22)		367,872				
<b>Stockholders equity</b>						
Common stock, W5,000 par value; 1 billion shares authorized; 359,207,313 shares issued and 347,597,116 shares outstanding in 2005; 381,567,614 shares issued and 374,437,647 shares outstanding in 2006 (Note 21)	W	1,796,037	W	1,907,838	\$	2,051,439
Additional paid-in capital		2,406,665		2,710,093		2,914,079
Retained earnings (Note 23)		3,953,742		5,145,966		5,533,297
Accumulated other comprehensive income (loss), net of taxes (Note 37)		(100,202)		376,952		405,324
Less: treasury stock, at cost, 11,610,197 shares in 2005 and 7,129,967 shares in 2006 (Note 21)		(245,458)		(161,511)		(173,669)
Total stockholders equity	W	7,810,784	W	9,979,338	\$	10,730,470
Total liabilities, minority interest, redeemable convertible preferred stock and stockholders equity	W	155,115,313	W	175,331,564	\$	188,528,563

See accompanying notes to consolidated financial statements.

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**Shinhan Financial Group Co., Ltd. and Subsidiaries**  
**Consolidated Statements of Income**  
**Years Ended December 31, 2004, 2005 and 2006**

	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2006</b>
	<b>(In millions of Korean Won, except per share data)</b>			<b>(See Note 1) (In thousands of US\$, except per share data)</b>
<b>Interest and dividend income</b>				
Interest and fees on loans	W 6,142,356	W 6,295,473	W 7,380,474	\$ 7,935,993
Interest and dividends on securities (Note 7)	1,264,839	932,395	1,199,137	1,289,394
Interest and dividends on trading assets	168,152	111,070	146,747	157,792
Other interest income	136,558	148,603	166,281	178,797
<b>Total interest income</b>	<b>7,711,905</b>	<b>7,487,541</b>	<b>8,892,639</b>	<b>9,561,976</b>
<b>Interest expense</b>				
Interest on deposits	2,369,936	2,234,689	2,648,257	2,847,588
Interest on short-term borrowings (Note 13)	340,733	339,855	524,776	564,275
Interest on secured borrowings	299,173	239,663	333,516	358,620
Interest on long-term debt	1,099,175	1,182,132	1,393,701	1,498,603
Other interest expense	28,976	17,564	11,591	12,463
<b>Total interest expense</b>	<b>4,137,993</b>	<b>4,013,903</b>	<b>4,911,841</b>	<b>5,281,549</b>
<b>Net interest income</b>	<b>3,573,912</b>	<b>3,473,638</b>	<b>3,980,798</b>	<b>4,280,427</b>
Provision (reversal) for credit losses (Note 8)	135,414	(183,488)	225,846	242,845
<b>Net interest income after provision (reversal) for credit losses</b>	<b>3,438,498</b>	<b>3,657,126</b>	<b>3,754,952</b>	<b>4,037,582</b>
<b>Non-interest income</b>				
Commissions and fees (Note 18)	1,178,814	1,505,703	1,511,384	1,625,144
Net trust management fees	84,496	100,216	105,605	113,554
Net trading profits (Note 6)	138,025	116,279	141,046	151,663
Net gains (losses) on securities (Note 7)	(77,115)	96,227	30,548	32,847
Gain on other investment	53,356	283,619	206,963	222,541
Net gain on foreign exchange	352,696	93,771	229,448	246,718
Insurance income		188,722	1,365,533	1,468,315
Other (Note 19)	366,332	333,897	335,247	360,481
<b>Total non-interest income</b>	<b>2,096,604</b>	<b>2,718,434</b>	<b>3,925,774</b>	<b>4,221,263</b>
<b>Non-interest expense</b>				

Employee compensation and other benefits (Note 27)	1,216,625	1,480,293	1,788,758	1,923,395
Depreciation and amortization	428,835	377,350	470,807	506,244
General and administrative expenses	542,821	515,882	666,439	716,601
Credit card fees	147,190	134,489	204,594	219,994
Provision (reversal) for other losses	16,037	112,944	(16,217)	(17,438)
Insurance fees on deposits	123,358	124,826	127,518	137,116
Other fees and commission expense	240,560	291,819	357,882	384,819
Taxes (except income taxes)	92,096	109,918	95,868	103,084
Insurance operating expense		199,968	1,404,065	1,509,747
Minority interest	153,428	16,079	17,860	19,205
Other (Note 19)	347,290	330,838	465,172	500,185
Total non-interest expense	3,308,240	3,694,406	5,582,746	6,002,952

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Consolidated Statements of Income (Continued)  
Years Ended December 31, 2004, 2005 and 2006**

	2004		2005		2006		2006
	(In millions of Korean Won, except per share data)						(See Note 1) (In thousands of US\$, except per share data)
<b>Income before income tax expense, extraordinary item and cumulative effect of change in accounting principle</b>		2,226,862		2,681,154		2,097,980	2,255,893
Income tax expense (Note 25)		764,451		942,386		617,495	663,973
<b>Income before extraordinary item and cumulative effect of change in accounting principle</b>		1,462,411		1,738,768		1,480,485	1,591,920
Extraordinary item (Note 20)		27,508					
Cumulative effect of change in accounting principle, net of taxes (Notes 2, 10 and 28)		(23,049)				(10,184)	(10,951)
<b>Net income</b>	W	1,466,870	W	1,738,768	W	1,470,301	\$ 1,580,969
<b>Net income per share of common stock (Note 26)</b>							
Basic							
Income before extraordinary item and cumulative effect of change in accounting principle	W	4,860	W	5,190	W	3,978	\$ 4.28
Extraordinary item		94					
Cumulative effect of change in accounting principle, net of taxes		(79)				(27)	(0.03)
Net income per share	W	4,875	W	5,190	W	3,951	\$ 4.25
Diluted							
Income before extraordinary item and cumulative effect of change in accounting principle	W	4,333	W	4,882	W	3,978	\$ 4.28
Extraordinary item		82					
Cumulative effect of change in accounting principle, net of taxes		(68)				(27)	(0.03)



Net income per share	W	4,347	W	4,882	W	3,951	\$	4.25
Average common shares issued and outstanding		292,464,924		333,424,397		372,172,814		
Average diluted common shares issued and outstanding		337,479,411		356,140,320		372,172,814		

See accompanying notes to consolidated financial statements.

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**Shinhan Financial Group Co., Ltd. and Subsidiaries**  
**Consolidated Statements of Changes in Stockholders' Equity**  
**Years Ended December 31, 2004, 2005 and 2006**

	Common Stock		Additional	Retained	Accumulated	Treasury	Total
	Shares	Amount	Paid-in	Earnings	Other	Stock	Stockholders'
	(In millions of Korean Won and in thousands of US \$, except share and per share data)						
<b>Balance at January 1,</b>	294,401,300	W 1,472,007	W 1,073,307	W 1,188,688	W 58,096	W (396,700)	W 3,395,000
Comprehensive income:							
Income				1,466,870			1,466,870
Foreign currency							
Translation adjustments					(18,462)		(18,462)
Unrealized gains							
(Losses) on							
Available-for-sale securities					118,239		118,239
Comprehensive				1,466,870	99,777		1,566,647
Balance of common stock	24,917,711	124,588	427,305				551,604
Dividends declared							
(10 per share)				(158,717)			(158,717)
Issuance and accretion of							
Amount on redeemable							
Convertible preferred stock				(40,948)			(40,948)
Acquisition of treasury							
Stock						(203,827)	(203,827)
Issuance of treasury stock			158,361			396,696	555,057
Share-based compensation			7,839				7,839
Classification to accrued							
Expense			(8,623)				(8,623)
<b>Balance at December 31,</b>	319,319,011	W 1,596,595	W 1,658,189	W 2,455,893	W 157,873	W (203,831)	W 5,664,000
<b>Balance at January 1,</b>	319,319,011	W 1,596,595	W 1,658,189	W 2,455,893	W 157,873	W (203,831)	W 5,664,000
Comprehensive income:							
Income				1,738,768			1,738,768
Foreign currency							
Translation adjustments					(12,024)		(12,024)

Unrealized gains (losses) on available-for-sale securities					(246,051)		(246,051)
Change in comprehensive income				1,738,768	(258,075)		1,480,693
Balance of common stock	17,528,000	87,640	485,775				18,101,415
Issuance of redeemable convertible preferred stock							
Balance of common stock	22,360,302	111,802	256,070				22,728,174
Dividends declared (10 per share)					(232,749)		(232,749)
Dividends on redeemable convertible preferred stock					(8,170)		(8,170)
Reclassification of treasury stock						(42,392)	(42,392)
Change in treasury stock			80			765	845
Share-based compensation			19,791				19,791
Reclassification to accrued expense			(13,240)				(13,240)
<b>Balance at December 31,</b>	<b>359,207,313</b>	<b>W 1,796,037</b>	<b>W 2,406,665</b>	<b>W 3,953,742</b>	<b>W (100,202)</b>	<b>W (245,458)</b>	<b>W 7,810,000</b>

See accompanying notes to consolidated financial statements

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Consolidated Statements of Changes in Stockholders' Equity (Continued)  
Years Ended December 31, 2004, 2005 and 2006**

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income (loss), Net of Taxes	Treasury Stock	Total Stockholders' Equity
	Shares	Amount					
(In millions of Korean Won and in thousands of US \$, except share and per share data)							
<b>Balance at January 1,</b>	359,207,313	W 1,796,037	W 2,406,665	W 3,953,742	W (100,202)	W (245,458)	W 7,810,000
Comprehensive income:				1,470,301			1,470,301
Income							
Foreign currency							
Translation adjustments					(13,315)		(13,315)
Unrealized gains on							
Available-for-sale					490,469		490,469
Securities							
Other comprehensive				1,470,301	477,154		1,947,455
Income							
Conversion of							
Convertible							
Preferred stock into							
Common stock	22,360,301	111,801	256,040				367,141
Dividends declared				(278,077)			(278,077)
(100 per share)							
Acquisition of treasury stock			82,773			83,947	166,720
Reclassification to							
Retained expense			(35,385)				(35,385)
<b>Balance at December 31, 2006</b>	381,567,614	W 1,907,838	W 2,710,093	W 5,145,966	W 376,952	W (161,511)	W 9,979,000
<b>Balance at January 1,</b>	359,207,313	\$ 1,931,223	\$ 2,587,812	\$ 4,251,335	\$ (107,744)	\$ (263,933)	\$ 8,398,000
Comprehensive income:				1,580,969			1,580,969
Income							
Foreign currency							
Translation adjustments					(14,317)		(14,317)
Unrealized gains					527,385		527,385
(Losses) on							
Available-for-sale							

ities

comprehensive				1,580,969	513,068			2,094,
ne								
ersion of								
mable convertible								
rred stock into								
non stock	22,360,301	120,216	275,312					395,
dividends declared								
6 per share)				(299,007)				(299,
of treasury stock			89,004			90,264		179,
assification to								
ed expense			(38,049)					(38,
<b>nce at</b>								
<b>umber 31, 2006</b>	381,567,614	\$ 2,051,439	\$ 2,914,079	\$ 5,533,297	\$ 405,324	\$ (173,669)	\$	10,730,

See accompanying notes to consolidated financial statements.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Consolidated Statements of Cash Flows  
Years Ended December 31, 2004, 2005 and 2006**

	2004	2005	2006	2006
	(In millions of Korean Won)			(See Note 1) (In thousands of US\$)
<b>Cash flows from operating activities</b>				
Net income	W 1,466,870	W 1,738,768	W 1,470,301	\$ 1,580,969
Adjustments to reconcile net income to net cash provided by (used in) operating activities:				
Provision (reversal) for credit losses	135,414	(183,488)	225,846	242,845
Provision for future policy benefit		58,284	457,761	492,216
Depreciation and amortization	428,835	377,350	470,807	506,244
Accretion of discounts on long-term debt	324,866	181,038	100,719	108,300
Amortization on deferred loan fees and origination costs	92,399	47,071	36,332	39,067
Amortization on investment debt securities	16,482	30,863	33,680	36,215
Net (gain) on equity investments	(16,004)	(66,526)	(76,317)	(82,061)
Net trading profits	(138,025)	(116,278)	(141,046)	(151,662)
Net (gain) on sale of available-for-sale securities	(73,786)	(101,553)	(106,904)	(114,951)
Impairment loss on investment securities	150,901	5,326	76,357	82,104
Net (gain) loss on sale of premises and equipment	(15,275)	(20,318)	2,331	2,506
Provision (reversal) for other losses	16,037	112,944	(16,217)	(17,438)
Net (gain) on sales of other assets	(35,252)	(176,925)	(85,273)	(91,691)
Net unrealized foreign exchange (gain) loss	(151,351)	55,868	(4,977)	(5,352)
Minority interest in net income of subsidiaries	153,428	16,079	17,860	19,204
Expense on stock option	(1,604)	45,459	46,233	49,713
Impairment loss on intangible assets	1,893			
Impairment loss on goodwill			129,285	139,016
Impairment loss on other investments	15,521	20,958	31,351	33,711
Cumulative effect of change in accounting principle	23,049		10,184	10,951
Extraordinary gain	(27,508)			
Net (gain) loss on sale of loans	(1,032)	(94,411)	5,018	5,396
Net gain on retirement of bonds	(10,922)			
Net changes in:				
Restricted cash	361,287	(338,795)	(3,114,207)	(3,348,610)
Trading assets	(2,797,086)	2,229,181	(202,813)	(218,078)

Other assets (excluding assets for pending LG Card acquisition)	(2,466,414)	3,035,963	(2,061,943)	(2,217,143)
Trading liabilities	1,244,516	(713,088)	569,311	612,162
Accrued expenses and other liabilities	3,030,857	(3,147,189)	2,712,357	2,916,513
Net cash provided by (used in) operating activities	1,728,096	2,996,581	586,036	630,146

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Consolidated Statements of Cash Flows (Continued)  
Years Ended December 31, 2004, 2005 and 2006**

	2004	2005	2006	2006
	(In millions of Korean Won)			(See Note 1) (In thousands of US\$)
<b>Cash flows from investing activities</b>				
Net change in interest-bearing deposit assets	W 189,962	W (13,563)	W (98,420)	\$ (105,828)
Net change in call loans and securities purchased under resale agreements	295,274	66,636	239,270	257,280
Proceeds from sales of available-for-sale securities	12,071,514	13,295,391	16,691,300	17,947,634
Purchases of available-for-sale securities	(11,845,324)	(16,156,100)	(10,514,671)	(11,306,097)
Proceeds from maturities, prepayments and calls of held-to-maturity securities	2,142,497	1,307,473	2,588,671	2,783,517
Purchases of held-to-maturity securities	(1,596,763)	(1,178,122)	(7,216,116)	(7,759,265)
Loan originations and principal collections, net	(3,773,137)	(8,318,374)	(17,547,650)	(18,868,441)
Payments for repurchase of loans from KAMCO	(24,031)			
Proceeds from sales of premises and equipment	29,546	95,971	145,324	156,262
Purchases of premises and equipment	(222,825)	(282,909)	(594,429)	(639,171)
Net change in security deposits	1,757	(57,195)	(29,945)	(32,199)
Cash acquired from acquisitions of subsidiaries, net of cash paid	1,553	27,225		
Sale of equity interest in subsidiaries		73,489	609,039	654,881
Acquisition of equity interest in subsidiaries	(99,293)	(42,568)	(154,940)	(166,602)
Increase in other assets (relating to pending LG Card acquisition)			(519,318)	(558,406)
Net change in other investments	14,580	(201,062)	(93)	(100)
Net cash used in investing activities	(2,814,690)	(11,383,708)	(16,401,978)	(17,636,535)
<b>Cash flows from financing activities</b>				
Net increase (decrease) in interest-bearing deposits	(2,103,071)	3,447,855	8,535,560	9,178,022
Net increase in non-interest-bearing deposits	1,417,722	397,246	774,983	833,315



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Net increase (decrease) in short-term borrowings	(230,353)	1,059,981	(938,879)	(1,009,547)
Proceeds from issuance of secured borrowings	1,422,914	1,864,737	1,237,050	1,330,161
Repayment of secured borrowings	(1,431,081)	(671,123)	(1,213,438)	(1,304,772)
Proceeds from issuance of long-term debt	9,385,571	26,507,592	44,616,738	47,974,987
Repayment of long-term debt	(7,059,193)	(23,942,920)	(37,877,713)	(40,728,724)
Purchases of treasury stock	(204,150)	(479)	(315)	(339)
Reissuance of treasury stock	622,190	845	198,430	213,366

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Consolidated Statements of Cash Flows (Continued)  
Years Ended December 31, 2004, 2005 and 2006**

	2004	2005	2006	2006
	(In millions of Korean Won)			(See Note 1) (In thousands of US\$)
Cash dividends paid	W (166,670)	W (260,775)	W (282,851)	\$ (304,141)
Increase (decrease) of minority interest	(1,750)		68,371	73,517
Net cash provided by financing activities	1,652,129	8,402,959	15,117,936	16,255,845
Effect of exchange rate changes on cash	(18,432)	(25,350)	(45,073)	(48,466)
Net increase (decrease) in cash and cash equivalents	547,103	(9,518)	(743,079)	(799,010)
<b>Cash and cash equivalents</b>				
Beginning of year	1,896,797	2,443,900	2,434,382	2,617,615
End of year	W 2,443,900	W 2,434,382	W 1,691,303	\$ 1,818,605
<b>Supplemental disclosure of cash flow information</b>				
Cash paid for interest	W 4,088,833	W 3,880,792	W 4,746,165	\$ 5,103,403
Cash paid for income taxes	431,537	455,480	563,980	606,430
<b>Supplemental disclosure of non-cash investing and financing activities</b>				
Acquisitions:				
Fair value of net assets acquired	1,062,640	243,067		
Goodwill	(411,456)	289,800		
Cash paid	99,293	1,405		
Consideration other than cash	551,893	531,462		
Conversion of redeemable convertible preferred stock into common stock:				
Common stock		111,802	111,801	120,216
Additional paid-in-capital		256,070	256,070	275,344
Securities and other investments received in connection with loan restructuring	214,758	27,328	32,384	34,822
Preferred stocks acquired from Hanmaum Financial Company in exchange for non-performing loans	3,618			
Decrease in cumulative translation adjustments, net of taxes	(18,461)	(12,024)	(13,315)	(14,317)

Increase (decrease) in unrealized gains (losses) on available-for-sale securities, net of taxes	118,240	(246,051)	492,734	529,821
Account payable for contingent consideration	166,516	20,461		

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements****December 31, 2004, 2005, and 2006****1. General Information and Summary of Significant Accounting Policies*****Business***

Shinhan Financial Group Co., Ltd. is a financial holding company incorporated in the Republic of Korea (Korea) under the Financial Holding Company Act of Korea. Shinhan Financial Group Co., Ltd. and its subsidiaries (collectively the Group) engage in banking and a variety of related businesses to provide a wide range of financial services to corporations, governments, institutions and individuals.

The principal subsidiaries of the Group at December 31 are as follows:

	Country of Incorporation	Percentage of Ownership(1)		
		2004	2005	2006
Shinhan Bank(2)	Korea	100%	100%	100%
Chohung Bank(2)	Korea	100%	100%	0%
Good Morning Shinhan Securities Co., Ltd.	Korea	100%	100%	100%
Shinhan Card Co., Ltd.(2)	Korea	100%	100%	100%
Shinhan Capital Co., Ltd.	Korea	100%	100%	100%
Jeju Bank	Korea	62.42%	62.42%	62.42%
Shinhan Credit Information Co., Ltd.	Korea	100%	100%	100%
Shinhan Private Equity Inc.	Korea	100%	100%	100%
Shinhan Life Insurance Co., Ltd.	Korea	12.90%	100%	100%

***Notes:***

- (1) Direct and indirect ownership are combined.
- (2) On April 3, 2006, Shinhan Bank was merged into Chohung Bank with Chohung Bank being the surviving legal entity and Chohung bank changed its name to Shinhan Bank. In addition, Chohung Bank's credit card business was spun off and merged into Shinhan Card.
- (3) All holdings are in common stock of the respective subsidiaries.

The Group is subject to the provisions of the Financial Holding Company Act of Korea. Shinhan Bank, and Jeju Bank conduct operations in accordance with the provisions of the Bank Act of Korea, including their activities in the commercial banking business. Shinhan Bank and Jeju Bank also engage in the trust business subject to the Korean Trust Business Act and other relevant laws.

***Principles of Consolidation***

The consolidated financial statements include the accounts of Shinhan Financial Group Co., Ltd. and its majority-owned subsidiaries. The Group consolidates subsidiaries in which it holds, directly or indirectly, more than 50% of the voting rights or where it exercises control. All significant intercompany transactions and balances have been eliminated in consolidation. Operating results of companies purchased are included from the dates of the acquisition. Assets held in an agency or trust management capacities are not included in the consolidated financial statements. The Group accounts for investments in companies in which it owns voting or economic interest of 20% to 50% and for which it has significant influence over operating and financing decisions using the equity method of accounting, and the pro rata share of their income (loss) is included in other noninterest income (expense). Investments in joint ventures, where the Group does not have unilateral control, are also accounted for using the equity method of accounting. Investments in companies where the Group owns less than 20% and does not have the ability to exercise significant influence over operating and financing decisions are accounted for using the cost method of accounting. Income from these investments is recognized when dividends are received. As discussed

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

**Notes to Consolidated Financial Statements (Continued)**

below, the Group consolidates entities deemed to be variable interest entities (VIEs) when the Group is determined to be the primary beneficiary of the VIEs.

***Variable Interest Entities***

An entity is referred to as a variable interest entity (VIE) if it meets the criteria outlined in FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities* (revised December 2003) (FIN 46R), which are: (1) the entity has equity that is insufficient to permit the entity to finance its activities without additional subordinated financial support from other parties, or (2) the entity has equity investors that cannot make significant decisions about the entity's operations or that do not absorb the expected losses or receive the expected residual returns of the entity.

In addition, as specified in FIN 46R, a VIE must be consolidated by the Group if it is deemed to be the primary beneficiary of the VIE, which is the party involved with the VIE that has a majority of the expected losses or a majority of the expected residual returns or both.

Along with the VIEs that are consolidated in accordance with these guidelines, the Group has significant variable interests in other VIEs that are not consolidated because the Group is not the primary beneficiary. These include Special Purpose Entities (SPEs) where the Group provides credit enhancement or liquidity guarantees, and various investment trust funds. All other entities not deemed to be VIEs, with which the Group has involvement, are evaluated for consolidation under ARB No. 51, *Consolidated Financial Statements*, and SFAS No. 94, *Consolidation of All Majority-Owned Subsidiaries* (SFAS 94).

***Foreign Currency Translation***

Assets, liabilities and operations of foreign branches and subsidiaries are recorded based on the functional currency of each entity. For certain foreign operations, the functional currency is the local currency, in which case assets and liabilities are translated, for consolidation purposes, at current exchange rates from the local currency to the reporting currency, the Korean Won. Income and expenses are translated at the weighted-average exchange rate for the period. The resulting translation adjustments are reported as a component of accumulated other comprehensive income within stockholders' equity on an after-tax basis.

Foreign currency transactions executed by domestic Korean entities are accounted for at the exchange rates prevailing on the related transaction dates. Assets and liabilities denominated in foreign currencies are translated to the Korean Won using period-end exchange rates. Gains and losses resulting from the settlement of foreign currency transactions and from the translation of assets and liabilities denominated in foreign currencies are recognized in the consolidated statements of income except for gains and losses arising from the translation of available-for-sale securities which are recorded as a component of accumulated other comprehensive income within stockholders' equity on an after-tax basis.

***Use of Estimates***

The preparation of the consolidated financial statements requires management of the Group to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the period. Significant items subject to such estimates and assumptions include the carrying amount

of securities, intangibles and goodwill, valuation allowances for loans losses and unfunded lending commitments, deferred income tax assets, future policy benefits, deferred acquisition cost, valuation of business acquired and valuation of derivative instruments. Actual results could differ from those estimates.

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

**Notes to Consolidated Financial Statements (Continued)**

***Cash and Cash Equivalents***

For purposes of the consolidated statements of cash flows, cash and cash equivalents include cash on hand, cash items in the process of collection and amounts due from banks, other financial institutions and the Bank of Korea (BOK), all of which have original maturities within 90 days.

***Securities Purchased under Resale Agreements and Securities Sold under Repurchase Agreements***

Securities purchased under resale agreements and securities sold under repurchase agreements are treated as collateralized financing transactions and are carried in the consolidated balance sheets at the amount at which the securities will be subsequently resold or repurchased, including accrued interest, as specified in the respective agreements. Interest earned on resale agreements and interests incurred on repurchase agreements are reported as interest income and interest expense, respectively. The Group's policy is to take possession of securities purchased under agreements to resell. The market value of securities to be repurchased and resold is monitored, and additional collateral is obtained where appropriate to protect the Group against credit exposure.

***Trading Assets and Liabilities, including Derivatives***

Trading assets include securities that are bought and held principally for the purpose of selling them in the near term. Trading positions are carried at fair value and recorded on a trade date basis. The Group recognizes changes in the fair value of trading positions as they occur in net trading profits. Interest and dividends are included in interest and dividends on trading assets.

Trading assets and liabilities also include derivatives used for trading purposes and for non-trading purposes that do not qualify for hedge accounting and foreign exchange contracts which are recognized on the consolidated financial statements at fair value. Trading and non-trading derivatives include interest rate and foreign currency swaps, equity conversion options, credit indexed contracts, puts and calls, caps and floors, warrants, futures and forwards. The Group recognizes changes in the fair value of trading and non-trading derivatives that do not qualify for hedge accounting and foreign exchange contracts as they occur in net trading profits.

The fair value of trading securities, derivative financial instruments and foreign exchange contracts is determined using quoted market prices, including quotes from dealers trading those securities or instruments, when available. If quoted market prices are not available, the fair value is determined based on pricing models, quoted prices of instruments with similar characteristics, discounted cash flows or the net asset value of the investee, counterparty quotes or external valuations performed by qualified independent evaluators.

***Derivatives and Hedging Activities***

As part of its asset and liability management process, the Group uses various derivative instruments including interest rate and foreign currency swaps to manage various interest rate and foreign exchange exposures or modify interest rate characteristics of various balance sheet accounts. Certain derivative contracts such as interest rate swaps and cross currency swaps are entered into for non-trading purposes and intended to serve as economic hedges of risk but do not qualify for hedge accounting.



The Group accounts for derivative and hedging activities in accordance with the FASB Statement No. 133 (SFAS 133), amended by SFAS 138 and SFAS 149, *Accounting for Derivative Instruments and Hedging Activities*, which requires that all derivative instruments be recorded on the balance sheet at their respective fair value.

On the date a non-trading derivative contract is entered into, the Group designates the derivative as either a hedge of the fair value of a recognized asset or liability or of an unrecognized firm commitment (fair value hedge), a hedge of a forecasted transaction or the variability of cash flows to be received or paid related to a recognized asset or liability (cash flow hedge), a foreign-currency fair-value or cash-flow hedge (foreign currency hedge), or a hedge of a net investment in a foreign operation. For all hedging relationships the Group formally documents the hedging

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

relationship and its risk-management objective and strategy for undertaking the hedge, the hedging instrument, the hedged item, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method of measuring ineffectiveness. This process includes linking all derivatives that are designated as fair-value, cash-flow, or foreign-currency hedges to specific assets and liabilities on the balance sheet or to specific firm commitments or forecasted transactions. The Group also formally assesses, both at the hedge's inception and on an ongoing basis, whether the derivatives that are used in hedging transactions are highly effective in offsetting changes in fair values or cash flows of hedged items.

Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a fair-value hedge, along with the loss or gain on the hedged asset or liability or unrecognized firm commitment of the hedged item that is attributable to the hedged risk, are recorded in earnings. Changes in the fair value of a derivative that is highly effective and that is designated and qualifies as a cash-flow hedge are recorded in other comprehensive income to the extent that the derivative is effective as a hedge, until earnings are affected by the variability in cash flows of the designated hedged item. Changes in the fair value of derivatives that are highly effective as hedges and that are designated and qualify as foreign-currency hedges are recorded in either earnings or other comprehensive income, depending on whether the hedge transaction is a fair-value hedge or a cash-flow hedge. However, if a derivative is used as a hedge of a net investment in a foreign operation, its changes in fair value, to the extent effective as a hedge, are recorded in the cumulative translation adjustments account within other comprehensive income. The ineffective portion of the change in fair value of a derivative instrument that qualifies as a cash-flow hedge is reported in earnings. Changes in the fair value of derivative trading instruments are reported in current period earnings.

The Group discontinues hedge accounting prospectively when it is determined that the derivative is no longer effective in offsetting changes in the fair value or cash flows of the hedged item, the derivative expires or is sold, terminated, or exercised, the derivative is dedesignated as a hedging instrument because it is unlikely that a forecasted transaction will occur, a hedged firm commitment no longer meets the definition of a firm commitment, or management determines that designation of the derivative as a hedging instrument is no longer appropriate.

In all situations in which hedge accounting is discontinued and the derivative is retained, the Group continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in its fair value in earnings. When hedge accounting is discontinued because it is determined that the derivative no longer qualifies as an effective fair-value hedge, the Group no longer adjusts the hedged asset or liability for changes in fair value. The adjustment of the carrying amount of the hedged asset or liability is accounted for in the same manner as other components of the carrying amount of that asset or liability. When hedge accounting is discontinued because the hedged item no longer meets the definition of a firm commitment, the Group removes any asset or liability that was recorded pursuant to recognition of the firm commitment from the balance sheet, and recognizes any gain or loss in earnings. When it is probable that a forecasted transaction will not occur, the Group discontinues hedge accounting if not already done and recognizes immediately in earnings gains and losses that were accumulated in other comprehensive income.

The short-cut method of hedge accounting assumes no ineffectiveness in a hedging relationship involving an interest rate swap and an interest-bearing asset or liability. The changes in the fair value or cash flows that are attributable to the risk being hedged will be completely offset at the hedge's inception and on an on-going basis. Under the short-cut method, among other requirements, the critical terms of the derivative instrument and the hedged item should be initially the same and subsequently stay the same throughout the hedge's life to support the ongoing application of hedge accounting.

***Investment Securities***

Investments securities primarily consist of Korean Treasury, financial institutions mortgage-backed, corporate debt, and equity securities with readily determinable fair values. The Group classifies its debt securities in one of

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

**Notes to Consolidated Financial Statements (Continued)**

three categories: trading, available-for-sale, or held-to-maturity and its equity securities into trading or available-for-sale. Trading securities are bought and held principally for the purpose of selling them in the near term. Held-to-maturity debt securities are those securities in which the Group has the positive intent and ability to hold the security until maturity. All securities not included in trading or held-to-maturity are classified as available-for-sale.

Available-for-sale securities are recorded at fair value. Held-to-maturity debt securities are recorded at amortized cost, adjusted for the amortization or accretion of premiums or discounts. Unrealized holding gains and losses, net of the related tax effect, on available-for-sale securities are excluded from earnings and are reported as a separate component of other comprehensive income until realized. Realized gains and losses from the sale of available-for-sale securities are determined using the moving average method for equity securities or specific identification method for debt securities.

A decline in the market value of any available-for-sale or held-to-maturity security below cost that is deemed to be other-than-temporary results in a reduction in carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. To determine whether an impairment is other-than-temporary, the Group considers whether it has the ability and intent to hold the investment until a market price recovery and considers whether evidence indicating the cost of the investment is recoverable outweighs evidence to the contrary. Evidence considered in this assessment includes the reasons for the impairment, the severity and duration of the impairment, changes in value subsequent to year-end, and forecasted performance of the investee.

Premiums and discounts are amortized or accreted over the life of the related held-to-maturity or available-for-sale security as an adjustment to yield using the effective interest method. Dividend and interest income are recognized when earned.

***Non-marketable or Restricted Equity Securities***

The Group holds certain equity securities that do not have readily determinable fair values or have sales restrictions exceeding one year, which are not within the scope of SFAS 115, *Accounting for Certain Investments in Debt and Equity Securities*. Those investments are recorded as other investments under other assets in the consolidated balance sheets and are accounted for at cost, with dividend income earned on these securities recorded as non-interest income and any other-than-temporary impairment recorded as non-interest expenses.

***Loans***

Loans are reported at their outstanding principal balances net of any unearned income, charge-offs, unamortized deferred fees and costs on originated loans, and premiums or discounts on purchased loans. Loan origination fees and certain direct origination costs are deferred and recognized as adjustments to income over the lives of the related loans. Unearned income, discounts and premiums are amortized using methods that approximate the interest method.

The Group generally ceases the accrual of interest when principal or interest payments become one day past due. Any unpaid interest previously accrued on such loans is reversed from income, and thereafter interest is recognized only to the extent payments are received. In applying payments on delinquent loans, payments are applied first to delinquent interest, normal interest, and then to the loan balance until it is paid in full. Loans are returned to accrual status when all the principal and interest amounts contractually due are brought current. Interest accruals are continued for past-due loans collateralized by customer deposits.

Securities received by the Group involving loans that are restructured or settled are recorded at the fair value of the security at the date of restructuring or settlement. Any difference between the security's fair value and the net carrying amount of the loan is recorded as a charge-off or recovery, as appropriate, on the loan through the allowance for loan losses.

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

**Notes to Consolidated Financial Statements (Continued)**

Transfers of loans to third parties are accounted for as sales when control is surrendered to the transferee. The Group derecognizes the loans from the balance sheet including any related allowance, and recognizes all assets obtained, and liabilities incurred, including any recourse obligations to the transferee, at fair value. Any resulting gain or loss on the sales is recognized in earnings. Conversely, the Group only recognizes loans transferred from third parties on the balance sheet when the Group obtains control of the loans.

The Group provides equipment financing to its customers through a variety of lease arrangements. Direct financing leases are carried at the aggregate of lease payments receivable plus estimated residual value of the leased property, less unearned income. Unearned income is recognized using the effective interest method.

***Allowance for Loan Losses***

The Group's allowance for loan losses is based upon management's continuing review and evaluation of the loan portfolio and is management's best estimate of probable losses that have been incurred as of the balance sheet date. The determination of the allowance for loan losses hinges upon various judgments and assumptions, including but not limited to, management's assessment of probable losses on individual loans, domestic and international economic conditions, loan portfolio composition, transfer risks and prior loan loss experience. The allowance for loan losses is increased by the provision for loan losses, which is charged against current period operating results and decreased by the amount of charge-offs, net of recoveries.

The Group's allowance for loan losses consists of (a) specific allowances for specifically identified impaired borrowers, and (b) general allowances for homogeneous pools of commercial and consumer loans, and other loans which are not specifically identified as impaired.

A commercial loan is considered impaired when, after consideration of current information and events, it is probable that the Group will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the loan agreement. The Group considers the following types of loans to be impaired:

Loans classified as substandard or below according to asset classification guidelines of the Financial Supervisory Commission (FSC) of the Republic of Korea.

Loans that are 90 days or more past due; and

Loans which are troubled debt restructurings under U.S. generally accepted accounting principles (US GAAP)

Once a loan has been identified as individually impaired, impairment is measured in accordance with SFAS 114, *Accounting by Creditors for Impairment of a Loan*, as amended by SFAS 118. The Group's measurement of the impairment of a loan, with the exception of large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, is based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, on the loan's observable market price or on the fair value of the collateral if the loan is collateral dependent. If the resulting value is less than the book value of the loan, a specific allowance is established for an amount equal to the difference. Any amounts deemed uncollectible are charged against the allowance for loan losses. Recoveries of previously charged-off amounts are credited to the allowance for loan losses. Impairment criteria are applied to the entire loan portfolio, exclusive of leases and smaller-balance homogeneous

loans such as residential mortgage, consumer loans and credit cards, which are evaluated collectively for impairment. Smaller-balance commercial loans, managed on a portfolio basis, are also evaluated collectively for impairment.

The allowance for non-impaired corporate loans, consumer loans and credit card loans is determined using several modeling tools, including a delinquency roll-rate model for credit cards, as well as a risk rating migration model for homogeneous pools of consumer and commercial loans. The loss factors developed through the use of such models are based on the Group's historical loss experiences and may be adjusted for significant factors that, in management's judgment, affect the collectibility of the portfolio as of the evaluation date.

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

**Notes to Consolidated Financial Statements (Continued)**

The Group charges off unsecured consumer and credit card loan amounts past due greater than 180 days and the amount deemed uncollectible on financing leases is charged off when past due greater than one year.

With regard to loans sold with recourse obligations, the allowance for loan losses was re-established if loans sold with recourse obligations were reacquired, at an amount measured as of the date of reacquisition prior to January 1, 2005. Loans acquired on January 1, 2005 or after are recorded at fair value at the reacquisition date and the Group does not reestablish the allowance for loan losses for such loans. Any movement in the allowance in relation to these loans after reacquisition is included within the overall provision for loan losses during the relevant year. The related specific allowance for loan losses is transferred as cost of the net book value of the loan as of the date of sale when non-performing loans are sold and derecognized from the consolidated balance sheet.

***Allowance for Off-balance Sheet Credit Instruments***

The Group maintains an allowance for credit losses on off-balance sheet credit instruments, such as commitments to extend credit, guarantees, acceptances, standby and commercial letters of credit and other financial instruments to absorb estimated probable losses related to these unfunded credit facilities. The allowance is estimated based on the assessment of the probability of commitment usage and credit risk factors for loans outstanding to these same customers. The allowance for credit losses for off-balance sheet credit instruments is included in other liabilities.

***Foreclosed Assets***

Assets acquired through, or in lieu of, loan foreclosures are held for sale and are initially recorded at fair value at the date of foreclosure, establishing a new cost basis. Subsequent to foreclosure, the assets are carried at the lower of their carrying amounts or fair values, less cost to sell, based on periodic valuation reviews performed by management. Revenues and expenses from operations and changes in the valuation allowance are included in other non-interest expenses.

***Securitizations***

The Group primarily securitizes corporate loans, credit card receivables, mortgages and student loans.

There are two key accounting determinations that must be made relating to securitizations. First, in the case where the Group originated or owned the financial assets transferred to the securitization entity, a decision must be made as to whether that transfer is considered a sale under generally accepted accounting principles. If it is a sale, the transferred assets are removed from the Group's consolidated balance sheet with a gain or loss recognized. Alternatively, when the transfer is not considered as a sale but rather a financing, the assets will remain on the Group's consolidated balance sheet with an offsetting liability recognized in the amount of proceeds received.

Second, determination must be made as to whether the securitization entity is sufficiently independent. If so, the entity would not be included in the Group's consolidated financial statements. For each securitization entity with which it is involved, the Group makes a determination of whether the entity should be considered a subsidiary of the Group and be included in its consolidated financial statements or whether the entity is sufficiently independent that it does not need to be consolidated. If the securitization entity's activities are sufficiently restricted to meet accounting requirements to be a Qualifying Special Purpose Entities (QSPE), the securitization entity is not consolidated by the seller of transferred assets. If the securitization entity is determined to be a VIE, the Group consolidates the VIE if it is



the primary beneficiary.

For all other securitization entities determined not to be VIEs in which the Group participates, a consolidation decision is made by evaluating several factors, including how much of the entity's ownership is in the hands of third-party investors, who controls the securitization entity, and who reaps the rewards and bears the risks of the entity. Only securitization entities controlled by the Group are consolidated.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

Interest in the securitized and sold loans may be retained in the form of subordinated debts. Retained interests are primarily recorded as available-for-sale investments. Gains or losses on securitization and sale depend in part on the previous carrying amount of the loans involved in the transfer and proceeds are allocated between the loans sold and the retained interests based on their relative fair values at the date of sale. Gains are recognized at the time of securitization and are reported in non-interest income or expense.

The Group values its securitized retained interest at fair value using either financial models, quoted market prices, or sales of similar assets. Where quoted market prices are not available, the Group estimates the fair value of these retained interests by determining the present value of expected future cash flows using modeling techniques that incorporate management's best estimates of key assumptions, including prepayment speeds, credit losses, and discount rates.

***Transfers of Financial Assets***

For a transfer of financial assets to be considered a sale, the assets must have been isolated from the Group, even in bankruptcy or other receivership; the purchaser must have the right to sell or pledge the assets transferred, or the purchaser must be a QSPE and the Group does not maintain effective control. If these sale requirements are met, the assets are removed from the Group's consolidated balance sheet. If the conditions for sale are not met, the transfer is considered to be a secured borrowing, and the assets remain on the consolidated balance sheet. The sale proceeds are recognized as the Group's liability. A legal opinion on a sale is generally obtained for complex transactions or where the Group has continuing involvement with assets transferred or with the securitization entity. Those opinions must state that the asset transfer is considered a sale and that the assets transferred would not be consolidated with other assets in the event of the Group's insolvency.

***Premises and Equipment***

Buildings, equipment and furniture, leasehold improvements and operation lease assets are stated at cost less accumulated depreciation and amortization. Equipment under capital leases are stated at the present value of minimum lease payments. Depreciation of buildings and operating lease assets is calculated on the straight-line method over the estimated useful lives of the assets. Depreciation of equipment and furniture is calculated on a declining balance method over the useful lives of the assets. Equipment under capital leases and leasehold improvements are amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset. Gains or losses on sale of premises and equipment are determined by reference to their carrying amounts. Maintenance and repairs are charged to expense as incurred.

The Group capitalizes certain direct costs related to developing software for internal use, and amortizes such costs on a straight-line basis once the software is available for use in accordance with the Statements of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*.

The estimated useful lives of premises and equipment are as follows:

Buildings	40 years
Equipment and furniture	4-5 years

Leasehold improvements	5 years
Operating lease assets	3-5 years
Capitalized software costs	4-5 years

***Goodwill and Other Intangible Assets***

Goodwill represents the cost of an acquired business in excess of the fair value of the net assets acquired. Other intangible assets represent purchased assets that also lack physical substance but can be distinguished from goodwill because of contractual or other legal rights, or because the asset is capable of being sold or exchanged

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

either on its own or in connection with a related contract, asset, or liability. Goodwill and intangible assets acquired in a purchase business combination and determined to have an indefinite useful life are not amortized, but instead tested for impairment at least annually in accordance with the provisions of SFAS 142, *Goodwill and Other Intangible Assets*. Intangible assets with estimable useful lives are amortized over their respective estimated useful lives to their estimated residual values, and reviewed for impairment in accordance with SFAS 144, *Accounting for Impairment or Disposal of Long-Lived Assets*.

The Group's finite-lived intangible assets are comprised of core deposit, credit card relationship, brokerage customer relationship and Korea Securities Finance Corporation (KSFC) deposit, valuation of business acquired (VOBA) intangibles. Core deposit intangibles represent the value of the funding provided by a base of acquired demand and savings accounts, which the Group can expect to maintain for an extended period of time because of generally stable customer relationships. Credit card relationship and brokerage customer relationship intangibles reflect the value of revenues to be derived from a base of acquired customer credit card and brokerage accounts activities, which the Group can expect to maintain for an extended period of time. KSFC deposit intangibles represent the positive spread realized on the differences between the interest rate paid to the customers and the interest rate earned on the deposit with KSFC, which the Group can expect to maintain for an extended period of time. VOBA intangible represents the present value of future profits embedded in the acquired business, which is determined by estimating the net present value of future cash flows from the contracts in force at the date of acquisition. The Group has established VOBA primarily for its acquired traditional, interest-sensitive and variable businesses. Each of the traditional and interest-sensitive businesses is composed of life insurance and annuity contracts.

The finite-lived intangibles except VOBA are amortized using sum-of-the-years'-digit method over their estimated useful lives, which range from 1 to 18 years. The estimated weighted-average life of brokerage customer relationship intangibles, KSFC deposit intangibles and Shinhan Bank's core deposit intangibles and credit card relationship intangibles are approximately 3, 3, 10 and 5 years, respectively, reflecting the run-off of economic value. VOBA is amortized over the effective lives of the acquired contracts. For acquired traditional business, VOBA is amortized in proportion to gross premiums of insurance in force, as applicable. For acquired interest-sensitive and variable businesses, VOBA is amortized in proportion to gross profits arising from the contracts and anticipated future experience, which is evaluated regularly.

During 2004, the Group decided to change its method of calculating amortization on other intangible assets from the straight-line method to the sum-of-the-years'-digit (SYD) method. The Group changed its amortization method for intangible assets because it is believed that the SYD method better reflects the pattern in which the economic benefits of other intangible assets are consumed or otherwise used up. The new method has been applied retrospectively to the acquisitions of other intangible assets of prior years. The adjustment of W(23,049) million (net of W8,743 million in income taxes) included in 2004 income is the cumulative effect of applying the new method retroactively. The pro forma amounts shown below have been adjusted for the effect of the retrospective application of the new amortization method and the related income taxes.

**Actual          Pro Forma**  
**(In millions of Won, except**  
**per share data)**

**2004**

Income before extraordinary gain	1,462,411	1,462,411
Basic net income per share of common stock	4,860	4,860
Diluted net income per share of common stock	4,333	4,333
Net income	1,466,870	1,489,919
Basic net income per share of common stock	4,875	4,954
Diluted net income per share of common stock	4,347	4,415

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The Group's indefinite-lived intangible assets are composed of court deposits of Chohung Bank and KSFC borrowings. Court deposit intangible asset represent the value of the funding provided by a base of acquired court deposit accounts which the Group can expect to maintain for an indefinite period because that court deposit will be maintained indefinitely once appointed by courts. KSFC borrowing represents the value of the low cost funding from KSFC compared to the next available funding source in the market, and the Group expects to benefit from the borrowing agreement indefinitely because that borrowing agreement lasts indefinitely in accordance with the Securities and Exchange Law in Korea.

***Deferred Policy Acquisition Costs (DAC)***

Deferred Policy Acquisition Costs (DAC), included in other assets, represent the costs of acquiring new business, principally commissions, certain underwriting and agency expenses, and the cost of issuing policies.

For traditional business, DAC is amortized over the premium-paying periods of the related policies, in proportion to the ratio of the annual premium revenue to the total anticipated premium revenue in accordance with SFAS No. 60, *Accounting and Reporting by Insurance Enterprises* (SFAS 60). Assumptions as to the anticipated premiums are made at the date of policy issuance or acquisition and are consistently applied over the life of the policy.

For Interest-sensitive and variable businesses, DAC is amortized at a constant rate based upon the present value of estimated gross profits expected to be realized in accordance with SFAS No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from Sale of Investments* (SFAS 97). The effect of changes in estimated gross profits on unamortized deferred acquisition costs is reflected in the period such estimated gross profits are revised.

Deferred policy acquisition costs are reviewed to determine if they are recoverable from future income, including investment income, and, if not recoverable, are charged to expense. All other acquisition expenses are charged to operations as incurred.

***Future Policy Benefits***

The group's liability for future policy benefits is primarily comprised of the present value of estimated future payments to or on behalf of policyholders, where the timing and amount of payment depends on policyholder mortality or morbidity, less the present value of future net premiums. Major assumptions used for future policy benefits are mortality and interest rate assumption. Expected mortality is generally based on the Group's historical experience and Standard industry table including a provision for the risk of adverse deviation. Interest rate assumptions are based on factors such as market conditions and expected investment returns. Although mortality and interest rate assumptions are locked-in upon the issuance of new insurance or annuity business with fixed and guaranteed terms, significant changes in experience or assumptions may require the Group to provide for expected future losses on a product by establishing premium deficiency reserves. Premium deficiency reserves, if required, are determined based on assumptions at the time the premium deficiency reserve is established and do not include a provision for the risk of adverse deviation.

The group's liability for future policy benefits also includes a liability for unpaid claims and claim adjustment expenses. The Group does not establish loss reserves until a loss has occurred. However, unpaid claims and claim adjustment expenses includes estimates of claims that the Group believes have been incurred but have not yet been

reported as of the balance sheet date. The Group's liability for future policy benefits also includes liabilities for guarantee benefits related to certain nontraditional long-duration life and annuity contracts and unearned revenues.

***Separate Account Assets and Liabilities.***

Separate account assets and liabilities are reported at fair value and represent segregated funds that are invested for certain policyholders. The assets consist of equity securities, fixed maturities, policy loans and cash equivalents.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The assets of each account are legally segregated and are generally not subject to claims that arise out of any other business of the Group. Investment risks associated with market value changes are borne by the customers, except to the extent of minimum guarantees made by the Group with respect to certain accounts. The investment income and gains or losses for separate accounts generally accrue to the policyholders and are not included in the consolidated statements of income. Separate account assets and liabilities amounts are included in Other assets and Accrued expenses and other liabilities, respectively and amount of each account is W282,995 million.

***Insurance premium***

Insurance Premiums from long-duration contracts, other than interest-sensitive life contracts, are earned when due as determined by the respective contract and estimates for premiums due but not yet collected are accrued. Premium collected for interest-sensitive contracts are not reported as revenue in the consolidated statements of income. Premiums from short-duration insurance contracts, principally accident and health policies, are earned over the related contract period.

***Impairment***

In accordance with SFAS 144, long-lived assets, such as property, plant, and equipment, and purchased intangibles assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of the asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows or quoted market prices in active markets if available, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill and intangible assets that have indefinite useful lives are tested annually for impairment, and are tested for impairment more frequently if events and circumstances indicate that the asset might be impaired. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's fair value. For goodwill, the impairment determination is made at the reporting unit level and consists of two steps. First, the Group determines the fair value of a reporting unit and compares it to its carrying amount. Second, if the carrying amount of a reporting unit exceeds its fair value, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's goodwill over the implied fair value of that goodwill. The implied fair value of goodwill is determined by allocating the fair value of the reporting unit in a manner similar to a purchase price allocation, in accordance with SFAS 141, *Business Combinations*. The residual fair value after this allocation is the implied fair value of the reporting unit goodwill.

***Share-Based Compensation***

The Group uses a fair value method of accounting for share-based compensation provided to its employees and key executives. The Group values stock options issued based upon an option-pricing model and recognizes this value as an expense, adjusted for forfeitures, over the period in which the options vest. On January 1, 2006, the Company adopted SFAS No. 123(revised 2004), *Share-Based Payment*, which replaced the existing SFAS 123, which allowed using the intrinsic value method under APB 25. See Note 2 Accounting Changes and Future Application of Accounting



Standards for further information.

***Commissions and Fees***

Commissions and fees primarily consist of brokerage fees and commissions, credit card fees, fees on guarantees and import/export letters of credit, and commissions received on remittance, cash dispenser service,

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

**Notes to Consolidated Financial Statements (Continued)**

cash management services and others. These fees are recognized over the period during which the related services are rendered.

***Net Trust Management Fees***

The Group manages funds on behalf of its customers through operations of various trust accounts. The Group receives fees for managing those funds which are recognized when earned. The Group is also entitled to receive performance-based fees for certain trust accounts. These fees, if earned, are recognized at the end of the performance period. In addition, the Group is liable to compensate trust account holders for losses incurred in certain trust accounts, subject to minimum return and principal guarantees. Such losses arising from the trusts underperforming the guaranteed level are accrued at the end of each applicable year when they are considered probable and reasonably estimable, and are included in net trust management fees.

***Co-branding Credit Card Arrangements***

The Group has co-brand arrangements with certain vendors that entitle a cardholder to receive benefits, such as airline frequent-flyer points, based on purchases made with the card. These arrangements have remaining terms not exceeding five years. The Group makes monthly payments to the certain co-brand partners based on the volume of cardholders' purchases and on the number of points awarded to cardholders, and to the other co-brand partners, based on the numbers of points used when cardholders use the points awarded. The probable amount of payments to the co-brand partners is estimated considering historical payment experience and is recorded in other liability.

***Dormant Accounts***

Customers' deposit with a positive balance but no earnings for an extended period of time is considered as dormant accounts. Pursuant to the Korean Commercial Code, the Group is legally discharged of these dormant accounts if customers do not redeem deposits within five years after their contractual maturities. However, the Group is obligated to return these deposits with interest upon customers' requests consistent with Korean Banking Practices. With respect to the dormant accounts after the legal discharge, the Group estimates a redemption ratio based on past experience and recognizes gain on dormant accounts excluding expected redemption amounts as other non-interest income.

***Income Taxes***

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Deferred tax assets, including the tax effect on the carryforward tax losses, are recognized to the extent it is more likely than not that some portion or all of the deferred tax assets will be realized. The ultimate realization of deferred tax assets depends upon the generation of future taxable income during the periods in which those temporary differences become deductible. To the extent the deferred tax assets are not realizable, a valuation allowance is recognized.

***Earnings Per Share***

Earnings per share is computed after recognition of preferred stock dividend requirements. Basic earnings per share is computed by dividing income available to common stockholders by the weighted average number of

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

**Notes to Consolidated Financial Statements (Continued)**

common shares outstanding for the period. Diluted earnings per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised. It is computed after giving consideration to the weighted average dilutive effect of the Group's stock option, bonds with stock purchase warrants and redeemable convertible preferred stock. Dilutive potential common shares are calculated using the treasury stock method and if-converted method.

***Comprehensive Income***

The Group records unrealized gains and losses on available-for-sale securities and foreign currency translation adjustments in accumulated other comprehensive income (AOCI), net of taxes. Unrealized gains and losses on available-for-sale securities are reclassified to net income as the gains or losses are realized upon sale of the securities. Other-than-temporary impairment charges are reclassified to net income at the time of the charge. Translation gains or losses on foreign currency translation adjustments are reclassified to net income upon sale or liquidation of investments in foreign operations.

***Convenience Translation***

The Group operates primarily in Korea and its official accounting records are maintained in Korean Won. The US dollar amounts are provided herein as supplementary information solely for the convenience of the reader. Korean Won amounts are expressed in US dollars at the rate of W930.00 : US\$1, the United States Federal Reserve Bank of New York noon buying exchange rate in effect on December 31, 2006. Such convenience into US dollar should not be construed as representations that the Korean Won amounts have been, could have been, or could in the future be converted into US dollars at this or any other rate of exchange.

***Reclassification***

Certain reclassifications have been made in the prior years' consolidated financial statements to conform to the current year presentation for comparative purposes.

**2. Accounting Changes and Future Application of Accounting Standards**

***Accounting for Loan Commitments Accounted for as Derivatives***

In March 2004, the Securities Exchange Commission (SEC) issued Staff Accounting Bulletin No. 105, *Application of Accounting Principles to Loan Commitments* (SAB 105) which summarizes the views of the SEC staff regarding the application of US GAAP to loan commitments accounted for as derivative commitments. SAB 105 specifies that servicing assets embedded in commitments for loans to be held for sale should be recognized only when the servicing asset has been contractually separated from the associated loans by sale or securitization. This Bulletin is effective for loan commitments entered into after March 31, 2004 which did not have a material impact on the Group's consolidated financial statements.

***Accounting for Certain Loans or Debt Securities Acquired in a Transfer***

On January 1, 2005, Statement of Position (SOP) No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer* (SOP 03-3), was adopted for loan acquisitions. SOP 03-3 requires acquired loans to be recorded at fair value and prohibits carrying over valuation allowances in the initial accounting for acquired impaired loans. Loans carried at fair value, mortgage loans held for sale, and loans to borrowers in good standing under revolving credit agreements are excluded from the scope of SOP 03-3.

SOP 03-3 limits the yield that may be accreted to the excess of the undiscounted expected cash flows over the investor's initial investment in the loan. The excess of the contractual cash flows over expected cash flows may not be recognized as an adjustment of yield. Subsequent increases in cash flows expected to be collected are recognized

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

prospectively through an adjustment of the loan's yield over its remaining life. Decreases in expected cash flows are recognized as impairments.

***The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments***

On September 30, 2004, the FASB voted unanimously to delay the effective date of certain provisions of EITF 03-1, *The Meaning of Other-Than-Temporary Impairment and its Applications to Certain Investments*. The delay applies to both debt and equity securities and specifically applies to impairments caused by interest rate and sector spreads. In addition, the provisions of EITF 03-1 that were delayed relate to the requirements that a company declare its intent to hold the security to recovery and designate a recovery period in order to avoid recognizing an other-than-temporary impairment charge through earnings. On November 3, 2005, the FASB issued FASB Staff Position FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and its Applications to Certain Investments*, revising the guidance in EITF 03-1, which did not have a material impact on the Group's consolidated financial statements. The disclosures required by EITF 03-1 are included in Note 7 to the consolidated financial statements.

***Accounting for Conditional Asset Retirement Obligations***

On December 31, 2005, the Group adopted FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47) as used in SFAS 143. Conditional asset retirement obligations are legal obligations to perform an asset retirement activity in which the timing and / or method of settlement are conditional based upon a future event that may or may not be within the control of the Group. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement. FIN 47 clarifies that entities are required to recognize a liability for the fair value of the conditional asset retirement obligation if the fair value of the liability can be reasonably estimated and provides guidance for determining when entities would have sufficient information to reasonably estimate the fair value of the obligation. The implementation did not have a material impact on its consolidated financial statements.

***Share-Based Compensation***

On January 1, 2006, the Group adopted SFAS No. 123 (revised 2004), *Share-Based Payment* (SFAS 123R), which replaced the existing SFAS 123 which allowed using the intrinsic value method under APB 25, *Accounting for Stock Issued to Employees*. SFAS 123(R) requires companies to measure compensation expense for stock options and other share-based payments based on the instruments' grant date fair value, and to record expense based on that fair value reduced by expected forfeitures. The Group adopted this standard by using the modified prospective approach. Beginning January 1, 2006, the Group recorded incremental expense for stock options granted prior to January 1, 2006 (the date the Group adopted SFAS 123R) which equals the remaining unvested portion of the grant date fair value of those stock options, reduced by estimated forfeitures. The Group recorded incremental compensation expense of W10,184 million, net of tax of W3,863 million, during the year. Until 2005, the Group used a fair value method of accounting under SFAS 123 and used the Black-Scholes model as its option valuation method. During 2006, the Company added a Monte Carlo simulation model to reflect the market condition of certain stock options.

***Accounting for Exchange of Nonmonetary Assets***

On January 1, 2006, the Group adopted SFAS No. 153, *Accounting for Exchange of Nonmonetary Assets* (SFAS 153), which eliminates the APB Opinion No. 29 exception for nonmonetary exchanges of similar productive assets and

replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. A nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. The adoption of SFAS 153 did not have a material impact to the Group's consolidated financial statements.

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

**Notes to Consolidated Financial Statements (Continued)**

***Accounting Changes and Error Corrections***

On January 1, 2006, the Group adopted SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 requires retrospective application, unless impracticable, to prior-period financial statements for voluntary changes in accounting principles and changes required by an accounting pronouncement in the usual circumstances in which the pronouncement does not include specific transition provisions. This statement also requires that a change in depreciation, amortization, or depletion method for long-lived, nonfinancial assets be accounted for as a change in estimate effected by a change in accounting principle. The guidance for reporting the correction of an error in previously issued financial statements and a change in accounting estimate, and requiring justification of a change in accounting principle on the basis of preferability does not change from APB Opinion No. 20, *Accounting Changes*. The adoption of SFAS 154 did not have a material impact on the Group's financial statements.

***Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination***

In June 2005, the FASB ratified the Emerging Issues Task Force's Issue No. 05-06 *Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination* (EITF 05-06). EITF 05-06 provides that the amortization period used for leasehold improvements acquired in a business combination or purchased after the inception of a lease be the shorter of (a) the useful life of the assets or (b) a term that includes required lease periods and renewals that are reasonably assured upon the acquisition or the purchase. The provisions of EITF 05-06 are effective on a prospective basis for leasehold improvements purchased or acquired beginning in the second quarter of fiscal 2006. Adoption of Issue No. 05-06 did not have a material effect on the Group's consolidated financial statements.

***Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements***

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatements* (SAB 108). SAB 108 requires analysis of misstatements using both an income statement and a balance sheet approach in assessing materiality and provides for a one-time cumulative effect transition adjustment to beginning retained earnings for material prior year misstatements. SAB 108 is effective for second interim period of fiscal years beginning after November 15, 2006. The adoption of SAB 108 as of December 31, 2006, did not have a material impact on the Group's consolidated financial statements.

***Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans***

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, which amends SFAS No. 87, 88, 106, 132R (SFAS 158), which requires the recognition of a plan's overfunded or underfunded status as an asset or liability with offsetting adjustments to accumulated other comprehensive income. SFAS 158 also requires an employer to measure the funded status of a plan as of the date of its year-end statement of financial position and recognize actuarial gains and losses, prior service costs or credits, and transition assets or obligations as a component of accumulated other comprehensive income. The recognition of an asset and liability related to the funded status provision is effective for fiscal year ending after December 15, 2006 and the change in measurement date provisions is effective for fiscal years ending after December 15, 2008. The adoption of SFAS 158 as of December 31, 2006, did not have a material impact on the Group's consolidated financial statements.



***Accounting for Certain Hybrid Financial Instruments***

On February 16, 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* (SFAS 155), an amendment of SFAS 140 and SFAS 133. SFAS 155 permits the Group to elect to measure any hybrid financial instrument at fair value (with changes in fair value recognized in earnings) if the hybrid instrument

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

contains an embedded derivative that would otherwise be required to be bifurcated and accounted for separately under SFAS 133. The election to measure the hybrid instrument at fair value is made on an instrument-by-instrument basis and is irreversible. The Statement will be effective for all instruments acquired, issued, or subject to a remeasurement event occurring after the beginning of the Group's fiscal year that begins after September 15, 2006, with earlier adoption permitted as of the beginning of the Group's 2006 fiscal year, provided that financial statements for any interim period of that fiscal year have not been issued. The Group decided not to early adopt SFAS 155 effective January 1, 2006, and is currently evaluating the effect of SFAS 155.

***Accounting for Servicing of Financial Assets***

On March, 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* which amends SFAS 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, with respect to the accounting for separately recognized servicing assets and servicing liabilities. This Statement requires an entity to recognize a servicing asset or servicing liability each time it undertakes an obligation to service a financial asset by entering into a servicing contract in any of the following situations, a) a transfer of the servicer's financial assets that meets the requirements for sale accounting, b) a transfer of the servicer's financial assets to a qualifying special-purpose entity in a guaranteed mortgage securitization in which the transferor retains all of the resulting securities and classifies them as either available-for-sale securities or trading securities in accordance with SFAS 115 and c) an acquisition or assumption of an obligation to service a financial asset that does not relate to financial assets of the servicer or its consolidated affiliates. SFAS No. 156 also requires all separately recognized servicing assets and servicing liabilities to be initially measured at fair value, if practicable and permits an entity to choose either the amortization method or fair value measurement method for each class of separately recognized servicing assets and servicing liabilities. The statement is effective as of the beginning of the Group's first fiscal year that begins after September 15, 2006. The requirements for recognition and initial measurement of servicing assets and servicing liabilities should be applied prospectively to all transactions after adoption. The adoption of SFAS 156 as of January 1, 2007, did not have a material impact on the Group's consolidated financial statements.

***Accounting for Uncertainty in Income Taxes***

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109* (FIN 48). FIN 48 addresses the accounting for uncertainty in income tax positions by prescribing a consistent recognition threshold and measurement attribute for income tax positions taken or expected to be taken in an income tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 requires a two-step process in evaluating income tax positions. In the first step, an enterprise determines whether it is more likely than not that an income tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. Income tax positions meeting the more-likely-than-not recognition threshold are then measured to determine the amount of benefit eligible for recognition in the financial statements. Each income tax position is measured at the largest amount of benefit that is more likely than not to be realized upon ultimate settlement. The Group is currently evaluating the effect of FIN 48.

***Fair Value Measurements***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value

measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007. The Company is currently assessing the impact of adopting SFAS 157 on the Group's consolidated financial statements.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)*****The Fair Value Option for Financial Assets and Financial Liabilities***

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities* (SFAS 159). This statement permits companies and not-for-profit organizations to make a one-time election to carry eligible types of financial assets and liabilities at fair value, even if fair value measurement is not required under U.S. GAAP. SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Group is currently assessing the impact of adopting SFAS 159 on its consolidated financial statements.

**3. Business Changes and Developments*****Acquisition of minority interest of Good Morning Securities Co., Ltd.***

On September 17, 2004, the Group decided to incorporate Good Morning Shinhan Securities as a wholly-owned subsidiary of the Group through a tender offer and share exchange, at the board of directors' meeting. Pursuant to the resolution, the Group provided a tender offer for 11.99% of preferred shares in Good Morning Shinhan Securities at W2,500 per share from September 24, 2004 to October 13, 2004, and the Group purchased 8.95% of preferred shares in the market and through over-the-counter trading during the period. Additionally, on October 21, 2004, the Group purchased 27.26% of preferred shares in Good Morning Shinhan Securities at W2,495 per share in cash, which had been held by Good Morning Shinhan Securities, and with respect to the remaining shares, one share of common and preferred stock of Good Morning Shinhan Securities were exchanged for 0.1633 share and 0.0977 share in the Group, respectively, as of December 23, 2004. As a result, as of December 23, 2004, the Group's percentage of ownership increased to 100% and Good Morning Shinhan Securities became a wholly-owned subsidiary of the Group. The aggregate fair value of net assets acquired amounted to W358,828 million. In connection with additional acquisition, the Group recorded negative goodwill of W149,791 million. The negative goodwill was allocated to non-current assets acquired. Pursuant to SFAS 141, the Group recognized W27,508 million of extraordinary gain for the year ended December 31, 2004, which is the excess negative goodwill after allocation to premises and equipment, brokerage customer relationship and other intangible assets. See Note 20 for further information related to the extraordinary gain.

***Agreement with KDIC and acquisition of minority interest of Chohung Bank***

In relation to the acquisition of 80.04% of Chohung Bank with Korea Deposit Insurance Corporation (KDIC), the Group has an obligation to pay contingent consideration (Profit Earn-Out).

***Profit Earn-out***

A profit earn-out will be paid in an amount equal to 20% of Chohung Bank's consolidated net income for the years ended 2004, 2005, and 2006 in the aggregate, determined under Korean GAAP, in excess of W1.8 trillion. In the event that Chohung Bank's operation is merged into that of Shinhan Bank's, the net incomes of the Chohung Bank and Shinhan Bank of the two fiscal years prior to such merger shall be used as the basis for the calculation of net income for the fiscal year during the merger occurs.

Pursuant to the terms of the Agreements, the Group is required to obtain the consent of KDIC, to the extent permitted under applicable law, to declare and pay dividends on the Group's common stock in excess of W750 per share,

representing 15% of par value (W5,000), if the Group's net income as determined under Korean GAAP is below W800 billion in a given fiscal year and any of the RPS and the RCPS are outstanding.

The Group acquired 18.85% of minority shares in Chohung Bank through tender offer and share exchange in 2004. The Group provided a tender offer for 3.77% of shares in Chohung Bank at W3,500 per share from April 26, 2004 to May 17, 2004. With respect to share exchange for 15.08% of shares in Chohung Bank, the shareholders, who were against the share exchange, were entitled to sell their shares at W3,067 per share from May 25, 2004 to June 3, 2004, with a resolution of an shareholders' meeting of Chohung Bank held on May 24, 2004, and the

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

remaining shares were subject to share exchange, at the exchange ratio of 0.1354 share in the Group to each Chohung Bank share, on June 22, 2004.

As a result, the Group's percentage of ownership increased to 100% and Chohung Bank became a wholly-owned subsidiary of the Group. Upon the acquisition of 66,363,126 shares in Chohung Bank from shareholders, who were against the share exchange, Chohung Bank became the shareholder of the Group with 8,985,567 shares of common stock in the Group. The assets acquired and liabilities assumed of Chohung Bank were recorded at fair value. The acquisition resulted in negative goodwill, which was allocated to the identifiable intangible assets, premise and equipment on a pro rata basis.

		<b>(In millions of Korean Won)</b>
Cash	W	94,884
Stock exchange		331,263
Direct acquisition cost		565
<b>Total purchase price</b>	<b>W</b>	<b>426,712</b>
Allocation of purchase price:		
Fair value of net assets of Chohung Bank	W	403,111
Core deposit intangible asset		133,151
Court deposit intangible asset		115,364
Credit card relationship intangible asset		35,264
Negative goodwill		(260,178)
<b>Total purchase price</b>	<b>W</b>	<b>426,712</b>

The negative goodwill was allocated to non-current assets acquired as follows:

Premises and equipment	W	169,040
Core deposit intangible asset		89,067
Court deposit intangible asset		77,170
Credit card relationship intangible asset		23,589
Deferred tax		(98,688)
<b>Total allocation</b>	<b>W</b>	<b>260,178</b>

**Acquisition of Shinhan Credit Information Co., Ltd.**

On May 21, 2004, the Group decided to acquire 49% of total outstanding shares in Shinhan Credit Information Co., Ltd. (Shinhan Credit Information) from LSH Holdings LLC. As a result, the Group's ownership increased to 100% and Shinhan Credit Information became a wholly-owned subsidiary of the Group.

***Incorporation of Shinhan Private Equity Inc.***

On December 8, 2004, the Group incorporated Shinhan Private Equity Inc. (Shinhan Private Equity) as a wholly-owned subsidiary.

***Acquisition of Shinhan Life Insurance Co., Ltd.***

Shinhan Life Insurance Co., Ltd.(Shinhan Life Insurance) was incorporated in January 1990 under the laws of the Republic of Korea to engage in life insurance and related businesses. On December 13, 2005, the Group acquired the remaining 34,010,428 shares or 85.03% of the issued and outstanding common stock of Shinhan Life

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

Insurance where the Group had owned 14.97% interest in exchange of cash and shares of common stock of the Group. As a result, the Group's ownership increased to 100% and Shinhan Life Insurance became a wholly-owned subsidiary of the Group. 5,989,572 shares or 14.97% of common stock of Shinhan Life Insurance acquired before December 13, 2005 and owned by Shinhan Bank and Good Morning Shinhan Securities were also exchanged to common stock of the Group. The Group issued 17,528,000 shares at the exchange ratio 0.4382 share of the Group for each Shinhan Life Insurance share.

The acquisition was accounted for using the purchase method, with the Group being the accounting acquirer. The assets and liabilities of Shinhan Life Insurance were recorded at fair value, with the excess of the purchase consideration over the fair value of the net assets acquired, after allocating to identifiable intangible assets, recorded as goodwill. The consolidated financial statements of the Group for the year ended December 31, 2005 include the operations of Shinhan Life Insurance from December 1, 2005.

The following table summarizes the estimated fair values of the assets acquired and liabilities assumed at the date of acquisition:

		<b>(In millions of Korean Won)</b>
Cash and cash equivalents	W	5,108
Deposits		389,627
Trading securities		268,980
Available-for-sale securities		1,529,922
Loans, net of allowance for loan losses		1,155,413
Premises and equipment, net		12,446
Other assets		409,067
<b>Total assets</b>	<b>W</b>	<b>3,770,563</b>
Future policy benefit	W	4,012,622
Borrowings		39,962
Other liabilities		453,444
<b>Total liabilities</b>	<b>W</b>	<b>4,506,028</b>
Fair value of net liabilities of Shinhan Life Insurance	W	(735,465)

The allocation of the purchase consideration is as follows:

**(In millions  
of Korean Won)**



Cash	W	138
Stock exchange		531,394
Direct acquisition costs		1,335
Total purchase price	W	532,867
Allocation of purchase price:		
Fair value of net liabilities of Shinhan Life Insurance	W	(735,465)
Value of business acquired		978,532
Goodwill		289,800
Total purchase price	W	532,867

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**Table of Contents**

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

**Notes to Consolidated Financial Statements (Continued)**

Value of business acquired intangible asset(VOBA) represents the present value of future profits embedded in acquired business, which is determined by estimating the net present value of future cash flows from the contracts in force at the date of acquisition. VOBA is amortized over the effective lives of the acquired contracts.

***The Merger of Shinhan Bank and Chohung Bank***

On April 3, 2006, Shinhan Bank was merged into Chohung Bank with Chohung Bank being the surviving legal entity. In connection with the merger, each share of common stock of Shinhan Bank was exchanged for 3.867799182 shares of common stock of Chohung Bank. Immediately after the merger, Chohung Bank changed its name to Shinhan Bank .

Concurrently, there was a split-merger in which Chohung Bank's credit card business was spun-off and merged into Shinhan Card. In connection with the split-merger, 41,207,856 shares of common stock of Shinhan Card were issued to SFG in exchange for 42,008,463 shares of common stock of Chohung Bank and Shinhan Card assumed assets amounting to W1,967 billion, together with certain liabilities amounting to W1,797 billion relating to the credit card business of Chohung Bank. As a result of the split-merger, 42,008,463 shares of common stock of Chohung Bank were retired, resulting in a reduction in its shareholders' equity of approximately W210 billion.

***Acquisition of LG Card***

On March 19, 2007, the Group acquired 98,517,316 shares or 78.6% of the issued and outstanding common stock of LG Card, currently Korea's largest credit card company, from the creditors committee of LG Card, to achieve greater economies of scale in the Group's card operations, as well as to enhance its position as a balanced provider of banking and non-banking services with diversified revenue sources and enhanced synergy opportunities, including cross-selling. LG Card provides several services such as credit card services, factoring, installment financing and leasing, under the Act for Financial Companies Specializing in Loan Business. LG Card was listed on the Korea Stock Exchange on April 22, 2002.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The acquisition will be accounted for under the purchase method of accounting in accordance with SFAS 141. The purchase price has been allocated to the assets acquired and the liabilities assumed based on their estimated fair values as of February 28, 2007 as summarized below. The information below is unaudited and this allocation is based on management's current estimation and could change as the fair value calculations are finalized and more information becomes available.

		<b>(Unaudited)</b> <b>(In millions</b> <b>of Korean Won)</b>
Cash and cash equivalents	W	240,452
Deposits		2,289
Call loans		473,361
Trading assets		1,039
Securities		36,540
Loans, net of allowance for loan losses		8,218,874
Premises and equipment, net		105,548
Other assets		548,825
<b>Total assets</b>	<b>W</b>	<b>9,626,928</b>
Borrowings and debentures	W	5,818,374
Other liabilities		1,077,130
<b>Total liabilities</b>	<b>W</b>	<b>6,895,504</b>
Fair value of net assets of LG Card	W	2,731,424

The allocation of the purchase consideration is as follows:

		<b>(Unaudited)</b> <b>(In millions</b> <b>of Korean Won)</b>
Market value of consideration	W	6,676,519
Direct acquisition costs		7,225
<b>Total purchase price</b>	<b>W</b>	<b>6,683,744</b>
Allocation of purchase price:		
Fair value of net assets of LG Card (excluding effect of deferred taxes)	W	2,973,914

Deferred tax		(242,490)
Credit card relationship intangible asset		917,101
Goodwill		3,035,219
Total purchase price	W	6,683,744

Credit card relationship intangible reflects the estimated fair value of the credit card relationships acquired from LG Card from which the Group expects to derive future benefits over the estimated life of such relationships. The customer relationship intangible is amortized over its estimated useful life on a sum-of-the years -digits basis. The estimated weighted average life of the customer relationship intangible is approximately 6 years. The fair value of this asset was based principally upon the estimates of (i) the profitability of the acquired accounts and (ii) the projected run-off of the acquired accounts.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****4. Restricted Cash**

The following table summarizes the details of restricted cash at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Reserve deposits with the Bank of Korea	W 2,711,000	W 5,992,231
Cash restricted for investment activities	890,465	723,150
Other	42,302	42,662
	W 3,643,767	W 6,758,043

Reserve deposits with BOK represent the amounts required under the Bank of Korea Act for payment of certificate of deposits, other time deposits and mutual installment deposits. Cash restricted for investment activities represents the amounts that the Group is contractually restricted for lending purposes and is reserved solely for purposes of performing investment activities for its customers.

**5. Call Loans and Securities Purchased under Resale Agreements**

The following table summarizes call loans and securities purchased under resale agreements, at their respective carrying values, at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Call loans	W 1,359,738	W 455,559
Securities purchased under resale agreements	139,700	787,500
	W 1,499,438	W 1,243,059

Call loans are short-term lending among banks and financial institutions, with maturities of 30 days or less. Typically, call loans have maturities of one day.

Interest income from call loans and securities purchased under resale agreements, as included in other interest income, amounted to W93,091 million, W84,572 million and W72,833 million during the years ended December 31, 2004, 2005 and 2006, respectively.

The fair value of collateral received in connection with resale agreements that may be sold or repledged by the Group is W111,190 million and W787,273 million at December 31, 2005 and 2006, respectively.



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****6. Trading Activities**

The following table summarizes the details of trading assets, at fair value, at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Debt securities:		
Korean treasury and governmental agencies	W 492,776	W 493,918
Corporations	1,307,131	1,314,681
Mortgage-backed and asset-backed securities	140,052	73,984
Financial institutions	1,145,210	1,022,738
Equity securities	464,596	507,053
Derivative instruments:		
Foreign exchange derivatives	681,441	858,970
Interest rate derivatives	173,130	288,268
Equity derivatives	68,117	214,963
Credit derivatives	100	250
Commodity derivatives	11,167	86
Other trading assets commodity indexed deposits	23,323	61,981
	W 4,507,043	W 4,836,892

The following tables summarizes the details of trading liabilities, at fair value, at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Derivative instruments:		
Foreign exchange derivatives	W 692,923	W 837,402
Interest rate derivatives	237,853	461,031
Equity derivatives	71,884	239,334
Credit derivatives	371	342
Commodity derivatives	11,120	86
Other trading liabilities commodity indexed deposits	34,006	72,645
	W 1,048,157	W 1,610,840

The following table presents trading profits (losses) for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Debt securities	W 97,844	W 66,716	W 1,550
Equity securities	14,703	116,353	(11,961)
Derivative instruments	24,735	(66,852)	151,314
Other trading activities commodity indexed deposits	743	62	143
Net trading profits	W 138,025	W 116,279	W 141,046

For the years ended December 31, 2004, 2005 and 2006, net unrealized gains (losses) on trading securities of W(27,887) million, W98,922 million and W(7,228) million, respectively, were included in net trading profits.



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****7. Securities**

The following table summarizes the details of the Group's available-for-sale and held-to-maturity securities at December 31:

	2005			2006				
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (In millions of Won)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Available-for-sale</b>								
Securities:								
Treasury and Governmental	W 8,442,283	W 13,176	W 156,942	W 8,298,517	W 4,436,291	W 4,269	W 43,234	W 4,436,291
Banks	1,971,273	6,878	25,871	1,952,280	1,751,347	20,076	11,536	1,751,347
Insurance institutions	9,322,309	2,767	70,542	9,254,534	7,260,212	3,522	20,556	7,260,212
Local governments	51,615	39	1,956	49,698	30,047	8	955	30,047
Asset -backed and structured	946,843	1,892	2,479	946,256	2,270,423	2,136	3,883	2,270,423
Real estate equity	1,818,040	173,951	13,555	1,978,436	1,104,637	660,414	4,819	1,104,637
	W 22,552,363	W 198,703	W 271,345	W 22,479,721	W 16,852,957	W 690,425	W 84,983	W 16,852,957
<b>Held-to-maturity</b>								
Securities:								
Treasury and Governmental	W 1,686,368	W 28,218	W 8,349	W 1,706,237	W 2,504,536	W 53,100	W 2,158	W 2,504,536
Banks	65,818	649	147	66,320	63,947	440	329	63,947
Insurance institutions	1,210,888	1,809	5,085	1,207,612	4,959,314	65,279	6,584	4,959,314
Local governments					937		15	937
Asset -backed and structured					52,359	174	319	52,359
	W 2,963,074	W 30,676	W 13,581	W 2,980,169	W 7,581,093	W 118,993	W 9,405	W 7,581,093

The Bank of Korea (BOK) is the central bank that establishes monetary policies in Korea. Korea Development Bank (KDB) is owned and controlled by the Korean government. Of the total amounts listed above in the financial institutions category at December 31, 2005 and 2006, the fair value of available-for-sale debt securities included W5,453,090 million and W4,273,809 million, respectively, that were issued by BOK and KDB. Of the total amounts listed above in the financial institutions category at December 31, 2005 and 2006, the amortized cost of held-to-maturity debt securities included W901,154 million and W2,665,769 million, respectively, that were related to BOK and KDB.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The Group has recognized impairment losses on available-for-sale as a charge to net gains (losses) on securities, where decreases in value were deemed to be other-than-temporary during the years ended December 31, as follows:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Available-for-sale securities			
Debt Securities	W 122,316	W 494	W 68,175
Equity Securities	28,585	4,832	8,182
Total other-than-temporary impairment losses	W 150,901	W 5,326	W 76,357

The following table sets forth the current fair value and the associated unrealized losses on investments in available-for-sale debt securities, marketable equity securities and held-to-maturity debt securities with unrealized losses at December 31, 2006, by length of time that individual securities in each category had been in a continuous loss position:

	<b>Less Than 12 Months</b>		<b>12 Months or Longer</b>		<b>Total</b>	
	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>	<b>Fair Value</b>	<b>Gross Unrealized Losses</b>
	<b>(In millions of Won)</b>					
<b>Available-for-sale securities</b>						
Debt securities:						
Korean treasury and governmental agencies	W 1,090,276	W (3,210)	W 2,329,628	W (40,024)	W 3,419,904	W (43,234)
Corporations	363,505	(7,390)	403,103	(4,146)	766,608	(11,536)
Financial institutions	3,222,616	(8,805)	2,159,172	(11,751)	5,381,788	(20,556)
Foreign governments	13,405	(349)	3,762	(606)	17,167	(955)
Mortgage-backed and asset-backed securities	207,100	(1,503)	230,082	(2,380)	437,182	(3,883)
Marketable equity securities	82,737	(4,743)	1,421	(76)	84,158	(4,819)
	4,979,639	(26,000)	5,127,168	(58,983)	10,106,807	(84,983)

**Held-to-maturity securities**

## Debt securities:

## Korean treasury and governmental agencies

agencies	W	61,170	W	(124)	W	78,662	W	(2,034)	W	139,832	W	(2,158)
Corporations						14,601		(329)		14,601		(329)
Financial institutions		454,898		(5,277)		51,951		(1,307)		506,849		(6,584)
Foreign governments						922		(15)		922		(15)
Mortgage-backed and asset-backed securities		21,326		(157)		10,721		(162)		32,047		(319)
		537,394		(5,558)		156,857		(3,847)		694,251		(9,405)

## Total temporarily

impaired securities	W	5,517,033	W	(31,558)	W	5,284,025	W	(62,830)	W	10,801,058	W	(94,388)
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Included in W84,983 million of gross unrealized losses on available-for-sale securities at December 31, 2006 was W58,983 million of unrealized losses that have existed for a period greater than 12 months. These securities primarily include Korean treasury and government agencies and financial institutions debt securities. The unrealized losses for these securities is due primarily to the current interest rate and foreign exchange rate environment. The unrealized loss is unrelated to the credit quality of the securities.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

Management has determined that the unrealized losses on the Group's investments in equity and debt securities at December 31, 2006 are temporary in nature. The Group conducts a periodic review to identify and evaluate investments that have indications of possible impairment. An investment in a debt or equity security is impaired if its fair value falls below its cost and the decline is considered other-than-temporary. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been below cost; the financial condition and near-term prospects of the issuer; and the Group's ability and intent to hold the investment for a period of time sufficient to allow for any anticipated recovery. The Group's review for impairment generally entails:

Identification and evaluation of investments that have indications of possible impairment

Analysis of individual investments that have fair values less than 80% of amortized cost, including consideration of the length of time the investment has been in an unrealized loss position

Discussion of evidential matter, including an evaluation of factors or triggers that would or could cause individual investments to qualify as having other-than-temporary impairments and those that would not support other-than-temporary impairment

Documentation of the results of these analyses as required under business policies

Any deterioration in Korean economic conditions or specific situations of the issuers of the securities could adversely affect the fair value of securities held by the Group.

The following table sets forth interest and dividends on securities for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Interest income	W 1,200,356	W 911,417	W 1,142,329
Dividends	64,483	20,978	56,808
	W 1,264,839	W 932,395	W 1,199,137

For the years ended December 31, 2004, 2005 and 2006, proceeds from sales of available-for-sale securities amounted to W12,071,514 million, W13,295,391 million and W16,691,300 million, respectively. Gross realized gains amounted to W146,002 million, W158,210 million and W187,108 million for the years ended December 31, 2004, 2005 and 2006, respectively. Gross realized losses amounted to W72,216 million, W56,657 million and W80,203 million for the years ended December 31, 2004, 2005 and 2006, respectively.

The following table sets forth the amortized cost and estimated fair value of the Group's available-for-sale and held-to-maturity debt securities at December 31, 2006 by contractual maturity. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties:

	<b>Available-for-Sale Debt Securities</b>		<b>Held-to-Maturity Debt Securities</b>	
	<b>Amortized Cost</b>	<b>Fair Value</b>	<b>Amortized Cost</b>	<b>Fair Value</b>
	<b>(In millions of Won)</b>			
Within 1 year	W 8,346,309	W 8,354,737	W 1,963,262	W 1,992,226
Over 1 year through 5 years	5,940,640	5,901,821	5,148,237	5,231,251
Over 5 years through 10 years	656,362	644,809	246,774	246,872
Over 10 years	92,206	91,017	222,820	220,332
Not due at a single maturity date	712,803	705,783		
	W 15,748,320	W 15,698,167	W 7,581,093	W 7,690,681

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****8. Loans**

The following table summarizes the details of the loan portfolio at December 31:

	<b>2005</b>		<b>2006</b>	
	<b>(In millions of Won)</b>			
Commercial:				
Commercial and industrial	W	35,728,132	W	40,062,760
Other commercial		21,408,703		27,319,293
Lease financing		754,473		584,641
Consumer:				
Mortgage and home equity		25,840,334		30,097,346
Credit cards		4,241,562		3,924,304
Other consumer		17,874,852		20,457,918
Total loans, gross		105,848,056		122,446,262
Deferred loan origination costs		110,401		117,852
		105,958,457		122,564,114
Less: Allowance for loan losses		1,511,503		1,575,013
Total loans, net	W	104,446,954	W	120,989,101

During 2005 and 2006, the Group received equity securities with a fair market value of W27,328 million and W2,365 million, respectively, through the restructuring of 12 loans in 2005 and 4 loans in 2006, with an aggregate book value of W39,668 million in 2005 and W3,640 million in 2006. The Group recognized aggregate charge-offs of W12,340 million and W1,275 million related to these transactions during the years ended December 31, 2005 and 2006, respectively.

Impaired loans are those on which the Group believes it is probable that it will not be able to collect all amounts due according to the contractual terms of the loan. The following table sets forth information about the Group's impaired loans at December 31:

	<b>2004</b>		<b>2005</b>		<b>2006</b>	
	<b>(In millions of Won)</b>					
Impaired loans with an allowance	W	2,268,924	W	1,794,283	W	1,219,816
Impaired loans without an allowance		376,606		490,913		155,093
	W	2,645,530	W	2,285,196	W	1,374,909

Allowance for impaired loans	W	885,332	W	703,529	W	864,802
Average balance of impaired loans during the year		2,057,663		2,039,445		1,402,510
Interest income recognized on impaired loans		90,548		70,116		56,106

Included in the above table were smaller balance commercial loans managed on a portfolio basis which were collectively identified as impaired amounting to W738,846, W784,945 million and W511,723 million at December 31, 2004, 2005 and 2006, respectively.

Loans that are 14 days or less past due in case of commercial loans and 30 days or less past due in case of consumer loans are regarded as nonaccrual loans in a repayment grace period and the Group does not generally request borrowers with such past due loans to make immediate repayment of the outstanding principal balances and related accrued interest. At December 31, 2004, 2005 and 2006, nonaccrual loans, excluding the past due loans within the repayment grace period, totaled W2,453,038, W2,052,473 million and W1,654,365 million, respectively.



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

Nonaccrual loans including the past due loans within the repayment grace period at December 31, 2006, totaled 2,099,305 million.

The following table presents, loans and debt securities whose terms have been modified in troubled debt restructuring at December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Loans	W 1,203,535	W 989,998	W 343,086
Debt Securities	120,838	44,248	47,361
	W 1,324,373	W 1,034,246	W 390,447

The following table sets forth the movements in the allowance for credit losses for the years ended December 31:

	<b>Allowance for Loan Losses</b>			<b>Allowance for Off-Balance Sheet Credit Instrument(1)</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>					
Balance at beginning of the year	W 3,630,728	W 2,310,555	W 1,511,503	W 176,653	W 115,616	W 187,274
Provision (reversal) for loan losses	195,446	(255,146)	252,346			
Provision (reversal) for off-balance sheet credit commitment				(60,032)	71,658	(26,500)
Allowance relating to:						
Acquisition of Shinhan Life Insurance		2,792				
Loans reacquired from KAMCO subject to recourse	1,900					

Other				(1,005)		
	1,900	2,792		(1,005)		
Charge-offs	(1,824,897)	(946,022)	(512,625)			
Recoveries	307,378	399,324	323,789			
Balance at end of the year	W 2,310,555	W 1,511,503	W 1,575,013	W 115,616	W 187,274	W 160,774

*Note:*

(1) The allowance for off-balance sheet credit instruments is included in other liabilities.

The Group originates direct financing leases on certain machinery, computers and various other equipment, automobiles and ships for customers in a variety of industries. Income attributable to these leases is initially recorded as unearned income and subsequently recognized as interest income, using the effective interest method, over the term of the leases. The terms of the leases are generally from 3 to 10 years. The following table sets forth the details of the net investment in direct financing leases at December 31, as included in the respective loan balances:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Gross lease payments receivable	W 807,291	W 632,397
Estimated unguaranteed residual values	24,030	19,583
Unearned income	(76,848)	(67,339)
	W 754,473	W 584,641

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The following table sets forth the scheduled maturities of net lease payments receivable at December 31, 2006:

<b>Years Ending</b>	<b>(In millions of Won)</b>	
2007	W	232,300
2008		133,778
2009		89,527
2010		56,042
2011		33,815
Thereafter		39,179
	W	584,641

**9. Premises and Equipment**

The following table summarizes the details of premises and equipment at December 31:

	<b>2005</b>		<b>2006</b>	
	<b>(In millions of Won)</b>			
Land	W	937,711	W	990,029
Buildings		730,675		776,108
Equipment and furniture		631,264		701,168
Capitalized software costs		195,063		312,938
Leasehold improvements		134,368		122,801
Construction in progress		10,164		19,667
Operating lease assets		116,859		76,614
Total premises and equipment, gross		2,756,104		2,999,325
Less: Accumulated depreciation and amortization		(879,608)		(902,219)
Total premises and equipment, net	W	1,876,496	W	2,097,106

Depreciation expense on buildings, equipment and furniture, leasehold improvements and operating lease assets amounted to W214,994 million, W187,748 million and W192,340 million, and amortization expense on capitalized software costs amounted to W26,273 million, W2,196 million and W33,824 million for the years ended December 31, 2004, 2005 and 2006, respectively. Accumulated depreciation on operating lease assets at December 31, 2005 and 2006 were W58,049 million and W48,876 million, respectively.



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****10. Goodwill and Intangible Assets**

The following table sets forth the movements in goodwill:

	<b>Shinhan Bank (formerly Chohung Bank)</b>	<b>Good Morning Shinhan Securities</b>	<b>Shinhan Capital (In millions of Won)</b>	<b>Shinhan Card (In millions of Won)</b>	<b>Shinhan Life Insurance</b>	<b>Total</b>
<b>Balance at January 1, 2005</b>	W 468,935	W 145,364	W 1,616	W	W	W 615,915
Acquisition					289,800	289,800
Disposition						
Impairment loss						
Other(1)	216,890					216,890
<b>Balance at December 31, 2005</b>	W 685,825	W 145,364	W 1,616		W 289,800	W 1,122,605
Acquisition						
Disposition						
Impairment loss		(129,285)				(129,285)
Other(2)	(99,378)			99,378		
<b>Balance at December 31, 2006</b>	W 586,447	W 16,079	W 1,616	W 99,378	W 289,800	W 993,320

*Note:*

- (1) Relates to contingent consideration (Asset Indemnity), settled by the additional payment of W220,714 million, which, as a result, was recognized as an additional goodwill, offset by adjustments to goodwill of W3,824 million relating to tax benefits from the valuation allowance recognized for operating loss carryforwards of Chohung Bank.
- (2) Relates to allocated goodwill to credit card business of Chohung Bank. On April 3, 2006, Chohung Bank's credit Card business was spun-off and merged into Shinhan Card.

The Group recorded goodwill and intangible assets of W289,800 million and W978,532 million, respectively, in connection with the acquisition of Shinhan Life Insurance in 2005.

The following table sets forth the movements in goodwill by reporting unit:

	<b>Retail Banking</b>	<b>Institutional Banking</b>	<b>Private Banking</b>	<b>Corporate Banking</b>	<b>Treasury &amp; International Business</b>	<b>Credit Card</b>	<b>Other Banking Services</b>	<b>Securities Brokerage Services</b>	<b>Other</b>
05	W 294,495	W	W	W 33,417	W 27,034	W 67,950	W 7,176	W 129,285	W 56,558 289,800
SS	136,209			15,456	12,503	31,428	3,319		17,975
W	430,704			W 48,873	W 39,537	W 99,378	W 10,495	W 129,285	W 364,333
SS	(95,726)	81,716	14,010					(129,285)	
W	334,978	W 81,716	W 14,010	W 48,873	W 39,537	W 99,378	W 10,495	W	W 364,333

*Note:*

(1) Relates to goodwill relating to acquisition of Shinhan Life Insurance.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

(2) Relates to contingent consideration (Asset Indemnity) paid to KDIC

(3) In accordance with SFAS 142, the former retail banking reporting unit has been reorganized.

Goodwill arises when the net book value of a reporting unit exceeds its estimated fair value. The Group's reporting units are generally consistent with the Group's business segment level, or one level below. The group performs impairment tests annually.

In 2006, a goodwill impairment loss of W129,285 million was recorded in the brokerage unit of Good Morning Shinhan Securities. The impairment loss was mainly triggered by the decrease of the trading volume affected by the increase of indirect investments. The fair value of the brokerage unit used for impairment test was determined based on the income approach.

The following table summarizes the details of intangible assets at December 31:

	2005		2006			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In millions of Won)					
Brokerage customer relationship	68,266	(66,207)	2,059	68,266	(67,378)	888
KSFC deposit	10,941	(10,649)	292	10,941	(10,815)	126
Core deposit of Shinhan Bank	825,476	(284,041)	541,435	825,476	(397,555)	427,921
Credit card relationship of Shinhan Card	198,320	(106,688)	91,632	198,320	(147,025)	51,295
VOBA	978,532	(5,822)	972,710	978,532	(95,276)	883,256
Total intangible assets subject to amortization	2,081,535	(473,407)	1,608,128	2,081,535	(718,049)	1,363,486
KSFC borrowing	400		400	400		400
Court deposit of Shinhan Bank	226,353		226,353	226,353		226,353
Total intangible assets subject to	226,753		226,753	226,753		226,753

amortization

W 2,308,288 W (473,407) W 1,834,881 W 2,308,288 W (718,049) W 1,590,239

Amortization expense on intangible assets was W187,568 million, W187,406 million and W244,642 million for the years ended December 31, 2004, 2005 and 2006, respectively.

On January 1, 2004, the Group changed its amortization method of intangible assets from the straight-line method to the sum-of-the-years digits method to better reflect the run-off of the economic value of intangibles. The cumulative effect of accounting change was W23,049 million, net of taxes of W8,743 million. The following table sets forth the estimated aggregate amortization expenses on intangible assets subject to amortization at December 31, 2006:

<b>Years Ending</b>	<b>(In millions of Won)</b>	
2007	W	254,955
2008		210,278
2009		166,694
2010		133,035
2011		107,342
Thereafter		491,182
	W	1,363,486



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

In 2006 and 2005, no impairment losses were recorded relating to other intangible assets. In 2004, an impairment loss of W1,893 million related to KSFC borrowing intangible asset was recorded. The impairment loss was determined based on the discount cash flow method.

**11. Other Assets**

The following tables summarizes the details of other assets at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Accrued interest and dividends receivable	W 555,193	W 672,928
Receivables for foreign exchange spot contracts	512,457	1,985,106
Accounts receivable	1,512,779	1,396,564
Accrued income	83,916	173,305
Deferred tax assets	183,604	258,615
Other investments(1)	1,419,128	1,054,994
Prepaid expenses	82,009	93,926
Separate account assets	124,249	282,995
Contract deposits for LG card acquisition		517,778
Advances to suppliers	23,653	27,502
Deferred acquisition costs	176,117	336,028
Hedging derivatives assets	1,391	5,391
Other	49,161	37,698
	W 4,723,657	W 6,842,830

*Note:*

- (1) Other investments include unlisted equity securities, securities with sales restriction and investments accounted for by the equity method.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****12. Deposits**

The following table summarizes the details of deposits at December 31:

	2005		2006	
	Balance	Weighted-Average Interest Rate	Balance	Weighted-Average Interest Rate
	(In millions of Won, except percentages)			
<b>Interest-bearing deposits</b>				
Demand deposits	W 6,997,857	1.90%	W 7,379,300	1.83%
Savings deposits	27,142,438	0.96%	29,057,275	2.12%
Certificate of deposits	10,649,687	3.81%	13,198,346	4.67%
Other time deposits	36,901,099	3.69%	41,100,714	3.57%
Mutual installment deposits	1,587,116	4.16%	842,666	3.88%
	83,278,197	2.71%	91,578,301	3.08%
<b>Non-interest-bearing deposits</b>				
Demand deposits	3,143,170		3,918,153	
	W 86,421,367	2.63%	W 95,496,454	3.00%

Interest-bearing demand deposits on December 31, 2006 primarily represented court related deposits held at Shinhan Bank. Other time deposits include premium accounts for loyal customers, tax savings accounts for high net worth customers, savings accounts for household financing and foreign currency deposits. Mutual installment deposits enable customers to become eligible for mortgage and other consumer loans as well as corporate loans while maintaining an account with the Group.

The aggregate amount of time deposit accounts (including CDs) in denominations of W100 million or more at December 31, 2005 and 2006 were W31,464,799 million and W37,070,424 million, respectively.

The following table sets forth the contractual maturities of certificate of deposits, other time deposits and mutual installment deposits at December 31, 2006:

Years Ending	(In millions of Won)
2007	45,508,341
2008	4,447,753

2009	3,097,138
2010	1,243,139
2011	357,994
Thereafter	487,361
	W 55,141,726

The KDIC provides deposit insurance up to a total of W50 million per depositor in each bank pursuant to the Depositor Protection Act for deposits due after January 1, 2001, regardless of the deposit date.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****13. Short-Term Borrowings**

The following table summarizes the details of short-term borrowings at December 31:

	<b>2005</b>		<b>2006</b>	
	<b>Balance</b>	<b>Weighted-Average Interest Rate</b>	<b>Balance</b>	<b>Weighted-Average Interest Rate</b>
	<b>(In millions of Won, except percentages)</b>			
Borrowings from BOK	W 1,668,335	1.85%	W 1,173,254	2.21%
Borrowings in foreign currencies	4,473,370	1.57%	3,211,017	2.79%
Borrowings from trust accounts	877,858	3.15%	1,122,533	4.09%
Call money	994,121	3.24%	1,686,036	4.77%
Other borrowings(1)	3,954,616	3.48%	3,802,186	3.87%
	W 11,968,300		W 10,995,026	

*Note:*

(1) The majority of other borrowings relate to borrowings from other financial institutions.

Short term borrowings consist of borrowed funds with original maturities of less than one year. Total interest expense on short-term borrowings amounted to W340,733 million, W339,855 million and W524,776 million, of which W115,780 million, W94,921 million and W146,308 million, respectively, were related to call money, during 2004, 2005 and 2006, respectively.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****14. Secured Borrowings**

The following table sets forth the details of the secured borrowings and relevant collateral at carrying values at December 31:

	Maturity	Secured Borrowings	2005 Collateral		Secured Borrowings	2006 Collateral				
			Loans(1)	Securities		Loans(1)	Securities			
(In millions of Won)										
Shinhan 2nd Securitization Specialty L.L.C. 10.00%-25.00% collateralized bond obligation	2008-2011	W	W	W	W	502	W	7,047	W	8,191
Shinhan 4th Securitization Specialty L.L.C. 20.00% collateralized bond obligation	2011					250		4,443		2,683
Sprout I ABS Specialty Co., Ltd. 1M Libor+0.60% collateralized bond obligation	2013	385,859	731,038		231,685		572,778			
Goldwing Co., Ltd. 4.30%-5.47% Asset-Backed Commercial Papers	2022	328,000	39,256	346,681	84,273		294,005			252,314
Shinhan Card 2003-1 Securitization Specialty L.L.C. 4.65% Type 1 beneficiary certificate	2009	406,086	701,366		406,086		707,915			
Shinhan 5th Securitization	2007	44,999	65,490							

Specialty L.L.C. 3.75%-3.86% collateralized bond obligation CHB NPL 2004-1 ABS Specialty Co., Ltd.	2007	79,904	98,897	1,474	39,981	81,827	
3.91%-4.49% collateralized bond obligation CHB NPL 2004-2 ABS Specialty Co., Ltd.	2007	84,865	141,239	2,541	39,969	96,932	2,515
3.54%-3.85% collateralized bond obligation KTF 3rd ABS Specialty Co., Ltd.	2007	199,853		200,000			
5.67% collateralized bond obligation Dogong 1st ABS Specialty Co., Ltd.	2006	143,500		152,500			
3.94%-7.00% ABCP and collateralized bond obligation Enclean 3rd ABS Specialty Co., Ltd.	2007	150,500		200,233	150,500		100,017
4.05%-30% ABCP and collateralized bond obligation Miraedon Co., Ltd.	2007	407,200		616,761	561,249		645,945
4.22%-4.68% Asset-Backed Commercial Papers Work and Joy 2004-1 ABS Specialty Co., Ltd.	2007	149,765		150,000	149,945		150,000
3.75% collateralized bond obligation Shinhan 6th Securitization	2007	124,668	144,677		70,085	52,314	

Specialty L.L.C. 3.94%-6.40% collateralized bond obligation HiBrand ABCP Ltd.	2008	48,050	47,191	41,050	42,879
3.95%-7.00% ABCP and collateralized bond obligation SamsungShinhan 4th ABS Specialty Co. Ltd	2009	250,346	250,500	250,499	250,500
4.13%-7.00% ABCP and collateralized bond obligation Dongbu Steel 2nd ABS Specialty Co. Ltd	2008	74,649	85,000	74,804	85,000
4.07% collateralized bond obligation Auto 2nd ABS Specialty Co., Ltd	2008	196,050	195,000		
4.22%-7.00% ABCP and collateralized bond obligation Blooming 2nd ABS Specialty Co., Ltd	2006	20,000	38,000		
4.13% Asset-Backed Commercial Papers					

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

	Maturity	Secured Borrowings	2005		2006		
			Loans(1)	Collateral Securities (In millions of Won)	Secured Borrowings	Loans(1)	Collateral Securities
CHB NPL 2005-1 ABS Specialty Co., Ltd 4.19%-4.52% collateralized bond obligation	2007	55,829	124,146	63	40,962	49,731	63
CHB NPL 2005-2ABS Specialty Co., Ltd 5.13%-5.78% collateralized bond obligation	2007	40,805	102,392		30,939	50,935	55
Cheongge ABS Specialty Co., Ltd 4.36% Asset-Backed Commercial Papers	2008	96,712		97,307	97,600		97,486
Humax 1st ABS Specialty Co., Ltd 4.36% Asset-Backed Commercial Papers	2006	40,000		62,328			
Shinhan 7th Securitization Specialty L.L.C. 4.85%-5.18% collateralized bond obligation	2009				94,716	198,538	
Frontier 9th ABS Specialty Co., Ltd 4.31%-7.00% collateralized bond obligation	2010				200,500		200,500
Ne DWC ABS Specialty Co., Ltd 5.21%-7.00% collateralized	2009				402,050		402,000



bond obligation Han-il U&I ABS Specialty Co., Ltd	2009				47,525		47,900
5.03%-8.00% collateralized bond obligation							
Other secured borrowings	2008	12,861	3,840	2,745	19,323		
5.85%-25% collateralized bond obligation							
Securities sold under repurchase agreements	2007	4,161,206		7,257,244	5,068,221		4,703,629
2.50%-15.6%							
		W 7,501,707	W 2,199,532	W 9,658,377	W 8,102,714	W 2,159,344	W 6,948,798

*Note:*

(1) Represents the carrying amounts, exclusive of the related specific allowance for loan losses.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****15. Long-Term Debt**

The following table summarizes the details of long-term debt at December 31:

	<b>Interest Rates (%)</b>	<b>Maturity</b>		<b>2005 (In millions of Won)</b>	<b>2006</b>
<b>Senior</b>					
<b>Won-denominated</b>					
Notes payable to the Small Business Corporation	2.00-4.90	2007-2017	W	492,543	W 564,842
Notes payable to the Industrial Bank of Korea	3.20-4.25	2007-2014		190,558	48,003
Notes payable to the Institute of Information Technology Assessment	1.60-3.30	2007-2011		150,821	70,670
Notes payable to the Korea Energy Management Corporation	1.00-4.50	2007-2021		265,740	298,389
Notes payable to other Korean Government Funds	1.00-5.50	2007-2021		255,685	274,951
Fixed and floating rate debentures(1)(2)	3.80-11.95	2007-2021		15,281,503	20,473,431
Other notes payable	2.00-5.10	2007-2020		1,684,662	1,679,100
Subtotal				18,321,512	23,409,386
<b>Foreign currency-denominated</b>					
Floating rate debentures(1)	0.12-6.83	2007-2021		714,384	1,433,290
Other floating rate notes payable	0.01-5.76	2007-2020		701,598	848,832
Subtotal				1,415,982	2,282,122
Total senior debt				19,737,494	25,691,508
<b>Subordinated</b>					
<b>Won-denominated</b>					
Hybrid bonds(3)	7.80	2033-2034		495,033	550,293
Other fixed rate notes payable(4)	5.82-14.45	2007-2016		3,640,192	3,978,909
Subtotal				4,135,225	4,529,202
<b>Foreign currency-denominated</b>					
Floating rate debentures(1)	1.89-5.13	2009-2014		50,650	139,704
Other fixed rate notes payable	4.50-6.25	2013-2015		607,800	1,254,960
Subtotal				658,450	1,394,664

Total subordinated debt			4,793,675	5,923,866
<b>Redeemable preferred stock(5)</b>				
Series 1 Redeemable preferred stock	4.04	2006	168,503	
Series 2 Redeemable preferred stock	4.04	2007	168,503	168,504
Series 3 Redeemable preferred stock	4.04	2008	168,504	168,504
Series 4 Redeemable preferred stock	4.04	2009	168,504	168,504
Series 5 Redeemable preferred stock	4.04	2010	168,504	168,504
Series 6 Redeemable preferred stock	7.00	2006	525,000	
Series 7 Redeemable preferred stock	7.46	2008	365,000	365,000
Series 8 Redeemable preferred stock	7.86	2010	10,000	10,000
Total redeemable preferred stock			1,742,518	1,049,016
Long-term debt, gross			26,273,687	32,664,390
Less: Unamortized discounts			(101,865)	(90,252)
Long-term debt, net			W 26,171,822	W 32,574,138

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)***Notes:*

- (1) Interest rates on floating rate debt were those rates in effect at December 31, 2006
- (2) Majority of these debentures related to miscellaneous bank borrowings from individual lenders.
- (3) Shinhan Bank has a call option that can be exercised five years after the issuance date, or earlier with the approval of the Financial Supervisory Service. The call options mature in 30 years from the issuance date, but may be extended by Shinhan Bank at any time.
- (4) Majority of these debentures related to miscellaneous bank borrowings from corporate lenders and Korean governmental entities.
- (5) See Note 22 for the terms of the RPS.

Long-term debt is denominated predominately in Korean Won, US dollars, or Japanese Yen with both fixed and floating interest rates. Floating rates are generally determined periodically by formulas based on certain money market rates tied to the six-month London Interbank Offered Rate (LIBOR) or the monthly Public Fund Prime Rate published by the Korean government, and are reset on a monthly, quarterly or semi-annual basis. The weighted-average interest rate for long-term debt was 5.32% and 4.83% at December 31, 2005 and 2006, respectively. Certain long-term debt agreements contain cross-default provisions and accelerating clauses for early termination in the event of default.

The following table sets forth the aggregate amount of long-term debt by contractual maturities at December 31:

<b>Years Ending</b>	<b>(In millions of Won)</b>	
2007	W	7,597,394
2008		9,843,272
2009		4,043,781
2010		1,036,907
2011		1,821,395
Thereafter		8,321,641
Long-term debt, gross		32,664,390
Less: Unamortized discount		(90,252)
Long-term debt, net	W	32,574,138

**16. Future Policy Benefits**

The following table summarizes future policy benefits at December 31:

	<b>2005</b>		<b>2006</b>
			<b>(In millions of Won)</b>
Life insurance	W 2,590,044	W	3,100,462
Annuity contracts	1,388,679		1,656,293
Other contracts	603,333		709,812
Unpaid claims and claim adjustment expenses	195,512		216,267
	W 4,777,568	W	5,682,834

Life insurance liabilities include reserves for death and endowment policy benefits, and certain health benefits. Annuity contract liabilities include reserves for individual life contingent immediate annuities. Other contract liabilities include unearned revenue and certain other reserves for group and individual life and health products.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

Future policy benefits are calculated using net level premium method based upon mortality, morbidity, persistency, and interest rate assumptions including provision for adverse deviation. Assumptions as to morality, morbidity and persistency are based on the Company's experience, or in certain instances, industry experience, when the basis of the reserve is established. For post-purchase, the best-estimated net investment rate used as the interest rate assumptions has been set equal to 6.0%, which is based on Shinhan Life Insurance's 2007 planned asset allocation and investment return. For pre-purchase, the best-estimated net investment rate is 5.5% in lock-in method.

**17. Accrued Expenses and Other Liabilities**

The following table summarizes accrued expenses and other liabilities at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Accrued interest and dividend payables	W 1,901,498	W 2,141,053
Payables for foreign exchange spot contracts	750,144	2,195,795
Accrued severance benefits	181,767	244,218
Accrued expenses	157,453	352,099
Accounts payable	1,096,240	1,261,545
Unearned income	147,502	196,737
Income tax payable	221,993	362,414
Withholding value-added tax and other taxes	88,221	109,921
Deferred tax liabilities	302,339	475,858
Security deposits received	299,814	257,368
Due to agencies	1,118,606	802,094
Allowance for losses on off-balance sheet credit instruments	187,274	160,774
Utility bill payments received on behalf of government	59,112	94,089
Separate account liabilities	124,249	282,995
Hedging derivative liabilities	13,132	6,628
Other	439,768	367,312
	<b>W 7,089,112</b>	<b>W 9,310,900</b>

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****18. Commissions and Fees**

The following table sets forth the details of commissions and fees from non-trust management activities for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Brokerage fees and commissions	W 231,520	W 345,265	W 479,327
Other fees and commissions:			
Credit card fees	360,624	421,249	455,980
Commissions received on remittance	78,657	72,626	71,437
Commissions received on import and export letters of credit	80,528	70,625	57,411
Financial guarantee fees	24,916	21,358	21,745
Commissions received in foreign exchange activities	68,391	70,325	64,110
Commission received as agency	49,132	71,032	28,302
Commission received as electronic charge receipt	74,232	69,962	65,301
Prepayment penalty fees	33,958	35,245	40,772
Other fees	176,856	328,016	226,999
Total other fees and commissions	947,294	1,160,438	1,032,057
	W 1,178,814	W 1,505,703	W 1,511,384

**19. Other Non-interest Income and Other Non-interest Expenses**

The following table sets forth the details of other non-interest income for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Gain on sale of premises and equipment	W 30,408	W 74,868	W 8,757
Income from operating leases	52,787	42,227	32,085
Rental income	15,199	15,870	16,718
Extinguished escheatment of deposits	13,353	1,383	28,513
Other	254,585	199,549	249,174
	W 366,332	W 333,897	W 335,247

The following table sets forth the details of other non-interest expenses for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Impairment loss on intangible assets	W 1,893	W	W
Impairment loss on goodwill			129,285
Impairment loss on other investments	15,521	20,958	31,351
Loss on sale of premises and equipment	15,134	54,550	11,089
Loss on sale of other real estate	1,448	6,758	303
Other	313,294	248,572	293,144
	W 347,290	W 330,838	W 465,172

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****20. Extraordinary Gain**

As discussed in Note 3, on December 23, 2004, the Group acquired all the remaining 39.53% of the outstanding common shares of Good Morning Shinhan Securities that it did not already own. The exchange ratio was 6.1237 share of Good Morning Shinhan Securities common stock for one share of the Group's common stock as determined based on the relative stock prices of the Group's common stock to those of the common stock of Good Morning Shinhan Securities on certain agreed periods and dates. The acquisition was accounted for using the purchase method.

Prior to the share swap, certain dissenting minority shareholders exercised their right to have Good Morning Shinhan Securities repurchase their shares at W3,330 per share. Accordingly, Good Morning Shinhan Securities purchased 2,992 common shares as treasury stock at an aggregate price of W10 million. Of the 10,041,638 common shares of the Group issued, 489 shares were issued in exchange for the treasury shares of Good Morning Shinhan Securities.

The purchase price for the outstanding shares of Good Morning Shinhan Securities was approximately W209,037 million based on the fair value of the common stock issued by the Group. The fair value of 39.53% of net assets acquired was W358,828 million. The excess of the fair value of the net assets acquired over the purchase consideration resulted in a negative goodwill of W149,791 million.

	<b>(In millions of Won)</b>	
Fair value of net assets of Good Morning Shinhan Securities	W	301,334
KSFC deposit intangible asset		6,276
Brokerage customer relationship intangible asset		50,956
KSFC borrowing intangible asset		262
Negative goodwill		(149,791)
 Total purchase price	 W	 209,037

The negative goodwill was allocated to non-current assets acquired as follows:

	<b>(In millions of Won)</b>	
Premises and equipment	W	111,172
KSFC deposit intangible asset		6,276
Brokerage customer relationship intangible asset		50,956
KSFC borrowing intangible asset		262
Deferred tax asset		(46,383)
Extraordinary gain		27,508
 Total allocation	 W	 149,791

Pursuant to SFAS 141, the Group first allocated the negative goodwill to the identifiable intangible assets, premises and equipment acquired on a pro rata basis. After the value of the identifiable intangible assets, premises and equipment was reduced to zero, the Group recognized an extraordinary gain of W27,508 million for the year ended December 31, 2004, which related to the unallocated negative goodwill.

## **21. Common Stock**

### *Issuances of common stock*

As of December 31, 2006, the Group had 381,567,614 shares of common stock issued and 374,437,647 shares of common stock outstanding. On September 16, 2003, the Group listed its shares on the New York Stock Exchange

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

**Notes to Consolidated Financial Statements (Continued)**

(NYSE) and transferred its global depository shares listed on the Luxembourg Stock Exchange to NYSE as American depository shares.

***Treasury stock***

The Korean Commercial Law requires companies involved in business combination transactions to obtain the approval of the acquiring company's stockholders and to provide an opportunity for dissenting stockholders to exercise appraisal rights. Upon exercise of the appraisal rights, these companies would be required to purchase stocks from those stockholders at a predetermined price.

The treasury stocks held by Shinhan Bank were 29,986,159 shares as of December 31, 2003. Shinhan Bank sold 29,873,295 shares of treasury stock in the Korean stock market at W21,000 per share through after-hour block trading on March 3, 2004, and 112,864 shares of treasury stock in the Korean stock market at various prices.

In 2004, Chohung Bank and Good Morning Shinhan Securities purchased their respective common stocks from dissenting stockholders. Those shares were subsequently exchanged to common stock of Shinhan Financial Group and became the treasury stock of the Group. The treasury stock held by Chohung Bank, Shinhan Bank and Good Morning Shinhan Securities were 8,985,567, 11,006 and 1,444 shares, respectively, as of December 31, 2004.

In 2005, as discussed in Note 3, shares of Shinhan Life Insurance held by Shinhan Bank and Good Morning Shinhan Securities were subsequently exchanged to common stock of Shinhan Financial Group and became the treasury stocks of the Group. The treasury stocks held by Chohung Bank, Shinhan Bank and Good Morning Shinhan Securities were 8,985,567, 2,420,955 and 203,675 shares, respectively, as of December 31, 2005.

In 2006, Shinhan Bank and Good Morning Shinhan Securities sold 4,480,230 shares of treasury stock in the Korean stock market at various prices. The treasury stock held by Shinhan Bank was 7,129,967 shares as of December 31, 2006.

**22. Redeemable Preferred Stock and Redeemable Convertible Preferred Stock**

In August 2003, in connection with the acquisition of Chohung Bank, the Group issued 46,583,961 shares of RPS, par value of W5,000 per share, with an aggregate estimated fair value of W710,258 million and 44,720,603 shares of RCPS, par value of W5,000 per share, with an aggregate estimated fair value of W714,780 million to KDIC, as well as 6,000,000 shares of RPS, par value of W5,000 per share, with an aggregate estimated fair value of W900,000 million to Strider ABS Specialty Co., Ltd. (Strider), a SPE established by the Group.

The RPS was issued in five series (Series 1 to 5) to KDIC and in three series (Series 6 to 8) to Strider on August 19, 2003, redeemable over seven years after the issue date. If there is any RPS outstanding on the last day of the redemption period (RPS Final Redemption Date), the Group will be obligated to redeem all outstanding RPS to the extent that distributable profits are available for such purchase. In the event that the Group does not have sufficient distributable profits to redeem all outstanding RPS on the RPS Final Redemption Date, the RPS will remain outstanding until sufficient distributable profits are available. The Group may, at its option, elect to redeem all or part of the outstanding RPS at any time during the redemption period. The holder of RPS will not have any voting rights, unless dividends on the RPS are not distributed in any given year, in which case each share of RPS will be given one

voting right. The Group may redeem the RPS from KDIC and Strider at W18,086 and W150,000 per share, respectively.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The dividends on the RPS are cumulative and non-participating on dividends on the common stock of the Group, and the stated dividend rates are as follows:

RPS issued to KDIC (Series 1 to 5)	4.04%
RPS issued to Strider:	
Series 6	7.00%
Series 7	7.46%
Series 8	7.86%

The RPS was initially measured at fair value as determined by the present value of its future cash dividend payments and repayment provisions, and discounts are amortized over the period from the date of issuance to the redemption date using the effective interest method. The RPS is classified as long-term debt on the Group's consolidated balance sheet as of December 31, 2006. In 2006, 12,816,792 shares amounting to W697,864 million were redeemed.

The Series 9 RCPS were issued to KDIC on August 19, 2003, redeemable at any time after the third anniversary date of the issue date and from time to time until the fifth anniversary date of the issue date. If there is any RCPS outstanding on the last day of the redemption period (RCPS Final Redemption Date), the Group is obligated to redeem the outstanding RCPS to the extent that distributable profits are available for the purchase. In the event that the Group does not have sufficient distributable profits to redeem all outstanding RCPS on the RCPS Final Redemption Date, the RCPS will remain outstanding until sufficient distributable profits are available.

The Group may, at its option, elect to redeem all or part of the outstanding RCPS at any time during the redemption period. KDIC may convert the RCPS into newly issued common stock of the Group at a conversion ratio of 1:1, based on a conversion schedule after the first anniversary date of the issue date until the fourth anniversary of the issue date. The holder of RCPS will not have any voting rights, unless dividends on the RCPS are not distributed in any given year, in which case each RCPS will be given one voting right. The dividends on the RCPS are cumulative and non-participating on dividends on the common stock of the Group, and the stated dividend rate is 2.02%. The RCPS were initially recorded at fair value as determined by the present value of its future cash dividend payments, repayment provisions and associated conversion features. The option to convert the RCPS to the Group's common stock was valued using a continuous binomial option-pricing model. The RCPS were classified outside stockholders equity as of December 31, 2005.

The discount on the RCPS has been amortized over the period from the date of issuance to the redemption date using the effective interest method through 2004. However, the Group did not amortize the discount on RCPS in 2005 because the Group believes it was not probable that the RCPS would become redeemable as the Group expects the RCPS to be converted into common stock prior to the redemption date. During 2005, 22,360,302 shares out of 44,720,603 shares were converted to common stock and during 2006, all remaining shares were converted to common stock.

**23. Retained Earnings**

The following table summarizes the details of retained earnings at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Appropriated retained earnings for legal reserves under Korean GAAP	W 223,722	W 396,928
Unappropriated retained earnings under US GAAP	3,730,020	4,749,038
	W 3,953,742	W 5,145,966

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The Financial Holding Company Act requires the Group to appropriate as a legal reserve under accounting principles generally accepted in Korea (Korean GAAP), an amount equal to a minimum of 10% of annual net income of Shinhan Financial Group until such reserve equals 100% of its paid-in capital. This reserve is not available for payment of cash dividends, but may be transferred to capital stock or used to reduce an accumulated deficit, if any, by an appropriate resolution of the Group's board of directors.

**24. Regulatory Requirements**

The Group and its subsidiaries, including Shinhan Bank, and Jeju Bank are subject to various regulatory capital requirements administered by the Financial Supervisory Commission (FSC), which are based on the Basel Committee on Banking Regulations and Supervisory Practices. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary actions by regulators that, if undertaken, could have a direct material effect on the Group's consolidated financial statements.

In conformity with the FSC regulations on financial holding companies, the Group applied the net equity to requisite capital ratio calculated under the FSC guidelines to evaluate its capital adequacy. All Korean financial holding companies must meet the minimum requisite capital ratio of 100%, as regulated by the FSC. Requisite capital, as required and defined by FSC, represents the sum of (a) the minimum equity capital amount necessary to meet the FSC guidelines for Shinhan Bank, and Jeju Bank, (b) 8% of its total assets on its balance sheet (including off-balance assets, if any) for other subsidiaries, and (c) 8% of its total assets on its balance sheet (including off-balance assets, if any, but excluding the book value of investments in and financial supports to its direct and indirect subsidiaries) for the Group.

The FSC regulations also require that the computation be based on the Group's consolidated financial statements under Korean GAAP and regulatory guidelines, which vary in certain significant respects from US GAAP.

The following table sets forth the Group's requisite capital adequacy ratio mandated by the FSC at December 31:

	<b>2005</b>		<b>2006</b>	
	<b>(In millions of Won, except capital ratio)</b>			
Equity Capital	W	11,434,001	W	14,184,052
Requisite Capital		8,609,121		10,183,478
Requisite Capital Ratio (%)		132.81%		139.28%

In conformity with the FSC regulations, Shinhan Bank, and Jeju Bank apply the FSC's risk-adjusted capital ratios to evaluate their capital adequacies. Korean banking organizations engaged in international banking are required to maintain a minimum 8% total risk-based capital ratio calculated by dividing total risk-adjusted capital by total risk-weighted assets, including a Tier 1 capital ratio of at least 4%. All Korean banking organizations subject to the FSC regulations on minimum capital adequacy ratio are also subject to periodic inspection by the Financial Supervisory Service (FSS). In the event that Shinhan Bank, or Jeju Bank does not maintain a consolidated capital ratio of 8%, it is subject to corrective actions to be imposed by the FSS, as recommended by the FSC based on the actual

financial position and capital ratio of the respective banking subsidiaries.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

As required by the FSC regulations, the following table sets forth the details of capital ratios calculated based on the consolidated financial statements of Shinhan Bank under Korean GAAP and regulatory guidelines which vary in certain significant respects from US GAAP at December 31:

	2005		2006	
	Shinhan Bank	Chohung Bank	Shinhan Bank	
	(In millions of Won, except capital ratio)			
Tier 1 capital	W 4,381,101	W 2,968,489	W 8,869,555	
Tier 2 capital	2,287,736	2,172,639	4,893,017	
Less: Investment in nonconsolidated Equity investees	(100,712)	(157,383)	(122,884)	
Total risk-adjusted capital	W 6,568,125	W 4,983,745	W 13,639,688	
Risk-weighted assets				
On-balance sheet assets	W 49,216,505	W 43,258,274	W 102,568,923	
Off-balance sheet assets	4,305,776	2,292,389	9,511,817	
Total risk-weighted assets	W 53,522,281	W 45,550,663	W 112,080,740	
Capital adequacy ratio (%)	12.27%	10.94%	12.17%	
Tier 1 capital ratio (%)	8.19%	6.52%	7.91%	
Tier 2 capital ratio (%)	4.27%	4.77%	4.37%	

Effective January 1, 2002, in addition to the existing capital ratio calculations, all banks in Korea are required to report to the FSC an alternative set of capital ratios, as follows, with components based on credit and market risks.

Shinhan Bank is subject to the same existing requirements to maintain minimum adequacy ratios at December 31:

	2005		2006	
	Shinhan Bank	Chohung Bank	Shinhan Bank	
	(In millions of Won, except capital ratio)			
Tier 1 capital	W 4,381,101	W 2,968,489	W 8,869,555	
Tier 2 capital	2,187,024	2,015,256	4,770,133	
Total risk-adjusted capital	W 6,568,125	W 4,983,745	W 13,639,688	
Total risk-weighted assets	W 53,708,592	W 45,546,697	W 113,557,486	
Capital adequacy ratio (%)	12.23%	10.94%	12.01%	

Tier 1 capital ratio (%)	8.16%	6.52%	7.81%
Tier 2 capital ratio (%)	4.07%	4.42%	4.20%

The Group's other subsidiaries, including Jeju Bank, Shinhan Card, Shinhan Life Insurance, Shinhan Capital and Good Morning Shinhan Securities are also subject to the capital ratio pursuant to other regulatory capital requirements of the FSC. At December 31, 2005 and 2006, the Group's other subsidiaries met the regulatory capital requirements of the FSC.

Table of Contents**Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****25. Income Taxes**

All but an insignificant portion of income before income tax expense and income tax expense is from Korean sources. The following table sets forth allocation of national and local income taxes between current and deferred portions for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
<b>Current tax expense</b>			
National	W 392,306	W 414,073	W 640,365
Local	39,231	41,408	64,036
Total current tax expense	431,537	455,481	704,401
<b>Deferred tax expense</b>			
National	302,649	442,641	(79,005)
Local	30,265	44,264	(7,901)
Total deferred tax expense	332,914	486,905	(86,906)
Total tax expense	W 764,451	W 942,386	W 617,495

The preceding table does not reflect the tax effects of unrealized gains and losses on available-for-sale securities. The tax effects of these items are recorded directly as other comprehensive income within stockholders' equity. See Note 37 for further information.

The following table sets forth a reconciliation of income tax expense at the Korean statutory income tax rate to actual income tax expense for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won, except tax rates)</b>		
Statutory tax rate	29.7%	27.5%	27.5%
Income before income tax expense, minority interest, extraordinary item and cumulative effect of a change in accounting principle	W 2,380,290	W 2,697,233	W 2,115,840
Income tax calculated at the statutory tax rate	706,946	741,739	581,856
Income not assessable for tax purposes	(75,926)	(25,519)	(223,044)
Expenses not deductible for tax purposes	171,556	205,402	329,395
Foreign tax rate differentials	(205)	(429)	(1,010)
	13,502	(7,670)	(16,387)

Adjustment of deferred tax liability on investment in subsidiaries and associates

Change in statutory tax rate(1)	(33,688)			
Change in valuation allowance	(18,125)		27,374	(54,222)
Other	391		1,489	907
Income tax expense	W 764,451	W 942,386	W 617,495	

*Note:*

- (1) In December 2003, the Korean government reduced the corporate income tax rate from 29.7% to 27.5%, effective from January 1, 2005.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The components of net deferred income tax assets and liabilities included in other assets and accrued expenses and other liabilities, respectively, at December 31, are as follows:

	<b>2005</b>		<b>2006</b>
	<b>(In millions of Won)</b>		
<b>Deferred income tax assets</b>			
Allowance for loan losses	W 14,078	W	216,895
Other allowances	172,768		104,606
Valuation of trading assets	12,588		7,662
Premises and equipment	40,349		107,218
Available-for-sale securities	323,181		428,742
Other assets	118,976		104,384
Future policy benefits	144,833		158,872
Long-term debt	35,763		38,216
Other temporary differences	5,704		21,497
Net operating loss carry forwards	32,520		20,817
	900,760		1,208,909
Less: Valuation allowance	(79,173)		(24,951)
Deferred income tax assets	821,587		1,183,958
<b>Deferred income tax liabilities</b>			
Valuation of trading assets	(8,006)		(4,257)
Foreign exchange contracts and derivative instruments	(22,956)		(4,316)
Allowance for loan losses	(191,901)		(490,117)
Accrued interest and dividend receivable	(52,393)		(90,216)
Other assets	(660,365)		(767,920)
Long-term debt	(294)		
Other temporary differences	(4,407)		(44,375)
Deferred income tax liabilities	(940,322)		(1,401,201)
Net deferred income tax liabilities	W (118,735)	W	(217,243)

Deferred income taxes at December 31, 2005 and 2006 are reflected in the consolidated balance sheets under the following captions:

**2005****2006**

**(In millions of Won)**

Other assets	W 183,604	W 258,615
Accrued Expenses and other liabilities	(302,339)	(475,858)
Total net deferred tax liabilities	W (118,735)	W (217,243)

In assessing the realizability of deferred tax assets, management considered whether it was more likely than not that some portion or all of the deferred tax assets would not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences became deductible. Management considered the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets were

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

deductible, management believed it was more likely than not that the Group would realize the benefits of these deductible differences, net of the existing valuation allowances at December 31, 2006. The amount of the deferred tax asset considered realizable, however, could be reduced in the near term if estimates of future taxable income during the carryforward period were reduced.

The valuation allowance was W135,322 million as of January 1, 2004. During the years ended December 31, 2004, 2005 and 2006, the valuation allowance increased / (decreased) by W(79,698), W23,549 and W(54,222) million, respectively. The valuation allowance for deferred tax assets in the amount of W3,824 million was credited to goodwill during the year ended December 31, 2005. At December 31, 2006, the Group had tax net operating losses totaling W75,698 million. The following table sets forth these net operating losses expiring in periods ranging from 2008 to 2011:

<b>Years Ending</b>	<b>(In millions of Won)</b>	
2007	W	
2008		1,118
2009		
2010		18,667
2011		55,913
	W	75,698

**26. Earnings Per Share**

The following is a reconciliation of the income and share data used in the basic and diluted earnings per share computation for the years ended December 31:

The following table sets forth the details of the calculation of earnings per share (EPS) for the years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won, except per share data)</b>		
<b>Basic EPS</b>			
Net income before extraordinary gain and cumulative effect of a change in accounting principle	W 1,462,411	W 1,738,768	W 1,480,485
Extraordinary gain, net of taxes	27,508		
Cumulative effect of a change in accounting principle, net of taxes	(23,049)		(10,184)
Accretion and dividends on redeemable convertible preferred stock	(40,948)	(8,169)	

Net income attributable to common stock shareholders	W	1,425,922		1,730,599		1,470,301
Weighted-average number of common stocks outstanding (in thousands)		292,465		333,424		372,173
Net earnings per share						
Net income before extraordinary gain and cumulative effect of a change in accounting principle	W	4,860	W	5,190	W	3,978
Extraordinary gain		94				
Cumulative effect of a change in accounting principle		(79)				(27)
Basic net income per share	W	4,875	W	5,190	W	3,951

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won, except per share data)</b>		
<b>Diluted EPS</b>			
Net income before extraordinary gain and cumulative effect of a change in accounting principle for purposes of computing diluted net income per share	W 1,462,411	W 1,738,768	W 1,480,485
Extraordinary gain, net of taxes	27,508		
Cumulative effect of a change in accounting principle, net of taxes	(23,049)		(10,184)
Net income attributable to common stock shareholders	W 1,466,870	W 1,738,768	W 1,470,301
Weighted-average number of common stocks outstanding (in thousands)	292,465	333,424	372,173
Diluted effect of redeemable convertible preferred stock (in thousands)	44,721	22,360	
Diluted effect of stock options (in thousands)	294	356	
Weighted-average number of common stock outstanding, Assuming dilution (in thousands)	337,480	356,140	372,173
Net earnings per share			
Net income before extraordinary gain and cumulative effect of a change in accounting principle	W 4,333	W 4,882	W 3,978
Extraordinary gain	82		
Cumulative effect of a change in accounting principle	(68)		(27)
Diluted net income per share	W 4,347	W 4,882	W 3,951

**27. Employee Severance Plans**

Employees with one or more years of service are entitled to receive a lump-sum payment upon termination of their employment with the Group, based on their length of service and rates of pay at the time of termination (the severance plan). Under the Korean National Pension Fund Law, the Group was required to pay a certain percentage of employee severance benefits to the National Pension Fund prior to April 1999. Additionally, the Group contributes voluntarily a certain percentage of employee severance benefits to a severance insurance deposit account (Severance Insurance Deposit) maintained for the benefit of employees at an insurance company. The Group has no additional liability once the amount has been contributed, thus the Group deducts contributions made to the National Pension Fund and the Severance Insurance Deposit from its accrued employee severance plan obligations. The compensation cost of employees' severance benefit is recognized based on the vested benefits to which the employees are entitled if they separate immediately.

Under limited circumstances, employees can withdraw their accumulated unpaid severance amounts before their termination of employment (interim severance payment). Such withdrawals were included in the amount of plan

payments for the years ended December 31, 2005 and 2006. Total interim severance payments made by the Group in 2005 and 2006 were W10,296 million and W14,817 million, respectively. The Group paid severance benefits of W95,234 million and W166,863 million for the years ended December 31, 2005 and 2006, respectively.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The following table sets forth the movements of accrued employee severance plan obligations included in accrued expenses and other liabilities at December 31:

	<b>2005</b>		<b>2006</b>
	<b>(In millions of Won)</b>		
<b>Balance at beginning of the year</b>	W 175,861	W	254,718
Severance benefits	181,603		263,348
Balance from the acquisition of subsidiaries	2,784		
Plan payments	(105,530)		(181,680)
	254,718		336,386
Less: Balance of payments remaining with National Pension Fund and severance insurance deposit	(72,951)		(92,168)
<b>Balance at end of the year</b>	W 181,767	W	244,218

The Group expects to pay the following future benefits to its employees upon their normal retirement age:

<b>Years Ending</b>	<b>(In millions of Won)</b>	
2007	W	27,730
2008		14,404
2009		10,957
2010		12,971
2011		18,871
2012-2016		153,292
	W	238,225

The above amounts were determined based on the employees' current salary rates and the number of service years that will be accumulated upon their retirement date. These amounts do not include amounts that might be paid to employees that will cease working with the Group before their normal retirement age.

**28. Employee Share-based Compensation and Other Benefits**

The Group has various share-based compensation plans to reward its employees and key executives of the Group, and measures share-based compensation expense using the fair value based method of accounting.

Share-based compensation expense was W3,715 million, W45,459 million and W60,280 million (including the incremental compensation expense of W14,047 million, pretax) in 2004, 2005 and 2006, respectively. The per share weighted fair value of the stock options granted to key employees, executives and directors of the Group was W7,351 for 2004 and W11,201 for 2005 and W5,797 for 2006. These amounts were estimated on the date of the grant using the Black-Scholes option-pricing model or Monte Carlo simulation model.

The following table illustrates the significant assumptions used to estimate the fair value of share options at the grant date:

	<b>Shinhan Financial Group</b>		
	<b>2004</b>	<b>2005</b>	<b>2006</b>
Risk-free interest rate	4.39%	4.07%	5.02%
Expected lives	3.50 years	5.00 years	5.00 years
Expected volatility	42.26%	42.31%	11.19%
Expected dividend rate	2.82%	2.79%	3.26%

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)*****Shinhan Financial Group Plan***

Shinhan Financial Group has authorized 65,122,736 shares of options to be granted to purchase its common stock. Shinhan Financial Group granted to its key employees, managements and directors of the Group 1,004,200 options, 1,156,300 options, 1,301,600 options and 2,695,200 options and 3,296,200 options at an exercise price of W18,910, W11,800, W21,595, and W28,006 and W38,829 per share with a vesting period of two years from the grant date in 2002, 2003, 2004, 2005 and 2006, respectively. Upon vesting, options may be exercised between two to seven years from the grant date. Options granted to managements and directors are performance based and linked to average market price of the Group's three main domestic competitors' shares. For the options granted except options issued on May 22, 2002, May 15, 2003 and March 25, 2004, Shinhan Financial Group may issue common stock or pay in cash the difference between the exercise and market price at the date of exercise. With regard to options granted on May 22, 2002, May 15, 2003 and March 25, 2004, Shinhan Financial Group decided to pay the difference between the exercise price and market price in cash at the date of exercise on May 21, 2004, May 17, 2005 and March 25, 2006, respectively.

***Shinhan Bank and Good Morning Shinhan Securities Plan***

Shinhan Bank and Good Morning Shinhan Securities granted share options to certain executives with a vesting period of two years from the grant date in 1999, 2000, 2001, 2002, 2003, and 2004, respectively. On March 4, 2004 and March 30, 2005 for Shinhan Bank, and on July 1, 2005 for Good Morning Shinhan Securities, both companies decided to settle all outstanding stock options for cash based on price calculated in reference to the market price of the common stock of Shinhan Financial Group, multiplied by exchange ratio.

A summary of the status of the Group's unvested options as of December 31, 2006, and changes during the twelve months ended December 31, 2006, is presented below:

	<b>Shinhan Financial Group</b>		<b>Shinhan Bank</b>		<b>Good Morning Shinhan Securities</b>	
	<b>Number</b>	<b>Weighted-Average Grant Date Fair Value Per Option</b>	<b>Number</b>	<b>Weighted-Average Grant Date Fair Value Per Option</b>	<b>Number</b>	<b>Weighted-Average Grant Date Fair Value Per Option</b>
	<b>of Options</b>	<b>(In Won)</b>	<b>of Options</b>	<b>(In Won)</b>	<b>of Options</b>	<b>(In Won)</b>
Unvested at January 1, 2006	3,820,566	9,943	302,350	952	569,266	1,097
Granted	3,296,200	5,797				
Vested	(1,243,723)	7,351	(22,350)	952	(345,477)	1,097
Forfeited	(393,884)	8,435	(280,000)	952	(223,789)	1,097

Unvested at December 31, 2006	5,479,159	8,145
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As of December 31, 2006, there was W23,503 million of total unrecognized compensation cost related to unvested stock awards net of the forfeiture provision. That cost is expected to be recognized over a weighted-average period of 0.8 years.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The following table presents the share option activities during the period indicated:

	Shinhan Financial Group			Shinhan Bank				
	Number of Options	Weighted- Average Exercise Price Per Option  (In Won)	Aggregate Intrinsic Value  (In million Won)	Number of Options	Weighted- Average Exercise Price Per Option  (In Won)	Aggregate Intrinsic Value  (In million Won)		
Outstanding at January 1, 2004	2,046,545	W 15,028		1,041,249	W 8,568			
Granted	1,301,600	21,595		340,000	5,000			
Exercised	(3,500)	18,910		(469,043)	12,693			
Forfeited	(247,703)	16,219		(5,316)	5,000			
Outstanding at December 31, 2004	3,096,942	17,698		906,890	5,118			
Granted	2,695,200	28,006						
Exercised	(363,665)	15,054		(1,750)	11,700			
Forfeited	(101,684)	26,360		(19,739)	5,000			
Outstanding at December 31, 2005	5,326,793	22,848		885,401	5,106			
Granted	3,296,200	38,829						
Exercised	(277,849)	17,647		(216,379)	5,054			
Forfeited	(393,884)	33,371		(280,000)	5,000			
Outstanding at December 31, 2006	7,951,260	W 29,133	W 140,233	389,022	W 5,395	W 365		
Exercisable at December 31, 2006	2,472,101	W 18,069	W 70,953	389,022	W 5,395	W 365		

**Good Morning Shinhan Securities**

Number of Options	Weighted-Average Exercise Price Per Option	Aggregate Intrinsic Value
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			(In Won)		(In million Won)
Outstanding at January 1, 2004	9,320,837	W	6,839		
Granted	633,000		5,000		
Exercised					
Forfeited	(115,812)		5,000		
Outstanding at December 31, 2004	9,838,025		6,743		
Granted					
Exercised					
Forfeited	(63,734)		5,000		
Outstanding at December 31, 2005	9,774,291		6,754		
Granted					
Exercised	(445,777)		5,076		
Forfeited	(223,789)		5,000		
Outstanding at December 31, 2006	9,104,725	W	6,879	W	12,744
Exercisable at December 31, 2006	9,104,725	W	6,879	W	12,744

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The total intrinsic value of options exercised during the year ended December 31, 2004, 2005, and 2006 was W9,594 million. W5,613 million, and W7,977 million, respectively.

The following table sets for the details of share options outstanding at December 31, 2006:

Exercise Price	Shinhan Financial Group Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted- Average Remaining Contractual Life(1)	Weighted- Average Exercise Price (In Won)	Number Exercisable	Weighted- Average Exercise Price (In Won)
W18,910	607,065	1.39	18,910	607,065	18,910
11,800	723,613	2.37	11,800	723,613	11,800
21,595	1,141,423	2.23	21,595	1,141,423	21,595
28,006	2,381,090	5.25	28,006		
38,829	3,098,069	6.22	38,829		
	7,951,260	4.64	29,133	2,472,101	18,069

Exercise Price	Shinhan Bank Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted- Average Remaining Contractual Life(1)	Weighted- Average Exercise Price (In Won)	Number Exercisable	Weighted- Average Exercise Price (In Won)
W5,260	99,054	1.24	5,260	99,054	5,260
5,000	84,672	1.33	5,000	84,672	5,000
5,600	187,200	0.24	5,600	187,200	5,600
5,860	18,096	0.24	5,860	18,096	5,860
	389,022	0.73	5,395	389,022	5,395

**Good Morning Shinhan Securities**

Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted-Average Remaining Contractual Life(1)	Weighted-Average Exercise Price (In Won)	Number Exercisable	Weighted-Average Exercise Price (In Won)
W7,640	2,588,355	2.10	7,640	2,588,355	7,640
7,085	1,434,510	2.10	7,085	1,434,510	7,085
7,590	1,980,000	0.96	7,590	1,980,000	7,590
5,850	1,220,000	2.40	5,850	1,220,000	5,850
6,040	90,000	3.08	6,040	90,000	6,040
6,370	540,000	5.40	6,370	540,000	6,370
5,837	343,383	5.40	5,837	343,383	5,837
5,000	908,477	1.96	5,000	908,477	5,000
	9,104,725	2.21	6,879	9,104,725	6,879

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**Table of Contents**

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

**Notes to Consolidated Financial Statements (Continued)**

*Note:*

(1) Contractual life indicates the sum of service (vesting) period and exercisable period.

***Employee Stock Ownership Association***

In 2002, the Group and Shinhan Bank established an employee stock ownership association (the ESOA) covering most of their employees. The Group makes discretionary cash contributions to the ESOA on a periodic basis as determined by the Group's Board of Directors. Shinhan Bank makes cash contributions to the ESOA on a periodic basis based on Shinhan Bank's actual performance relative to pre-specified net income. The Group and Shinhan Bank contributions are used to purchase shares of the common stock of the Group on the Korean Stock Exchange. All shares acquired by the ESOA are unallocated, and are restricted for a period of four years pursuant to the plan agreements and regulations governing the ESOA. In addition, under the Securities and Exchange Act of Korea, employees participating in the ESOA have a right of first refusal, subject to certain exceptions, to subscribe for up to 20% of the shares publicly offered by the Group pursuant to the Securities and Exchange Act of Korea.

Furthermore, this right is exercisable only to the extent that the total number of shares so acquired and held by such employees does not exceed 20% of the Group's total number of shares then outstanding. For the years ended December 31, 2004, 2005 and 2006, the Group recorded in aggregate W20,852 million, W7,744 million and W32,328 million in expenses related to the ESOA contributions, respectively.

**29. Fair Value of Financial Instruments**

The fair value of a financial instrument is the current amount that would be exchanged between willing parties, other than in a forced sale or liquidation. Fair value is best determined based on quoted market prices. However, in many instances, there are no quoted market prices for the Group's various financial instruments. In cases where quoted market prices are not available, the fair values are estimated using present value or other valuation techniques.

Those techniques are significantly affected by the assumptions used, which include expected future cash flows and discount rates. Accordingly, the fair value estimates may not be realized in an immediate settlement of the instruments. Certain financial instruments and all nonfinancial instruments are excluded from the scope of SFAS 107, *Disclosure about Fair Value of Financial Instruments*. Accordingly, the aggregate fair value amount of the items presented under SFAS 107 may not necessarily represent the total underlying fair value of the Group since the fair value of the excluded items are not obtained.

The following methods and assumptions are used by the Group in estimating fair value disclosures for its financial instruments:

*Assets and liabilities for which fair value approximates carrying value:* The carrying values of certain financial assets and liabilities are reported at cost, including cash and cash equivalents, restricted cash, call loans, accrued interest and dividends receivable, customers' liability on acceptances, accrued interest payable, security deposits, other assets except for nonmarketable equity investments, acceptances outstanding and other liabilities. The carrying values of these financial assets and liabilities are considered to approximate their fair values due to their short-term nature and

negligible losses due to credit risks.

*Interest-bearing deposits in banks:* The carrying amounts of short-term interest-bearing deposits approximate their fair value because they are short-term in nature or carry variable interest rates. Fair value of other interest-bearing deposits is estimated using discounted cash flow analysis on current rates for similar types of deposits.

*Trading assets and liabilities:* Fair values for trading assets, including derivative financial instruments so classified are based on quoted market prices, where available. If quoted market prices are not available, fair values

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

**Notes to Consolidated Financial Statements (Continued)**

are based on quoted market prices of comparable instruments except for certain options and swaps for which pricing models are used.

*Securities:* Fair values for available-for-sale and held-to-maturity securities are based on quoted market prices, or quoted market prices of comparable instruments if the quoted market prices are not available.

*Nonmarketable equity investments:* Nonmarketable equity investments, which are recorded in other assets, consist primarily of private equity investments. The fair values of these investments are based on the latest obtainable net asset value of the investees and adjusted for other-than-temporary impairment losses.

*Loans:* Loans and advances are net of allowance for loan losses. The fair value of fixed rate loans is estimated by discounting contractual cash flows based on current rates at which similar loans would be made to borrowers for the same maturities. The fair values of variable rate loans that re-price frequently with no significant changes in credit risk are considered to approximate their carrying values in the consolidated balance sheets.

*Deposits:* The carrying amounts of variable-rate interest and non-interest-bearing deposits approximate their fair values at the balance sheet date. Fair values for fixed rate interest-bearing deposits are estimated using discounted cash flow analysis using interest rates currently offered for deposits with similar maturities.

*Short-term borrowings:* The carrying amounts of call money, securities sold under repurchase agreements and short-term borrowings approximate their fair values due to their short-term nature and negligible losses due to credit risks.

*Long-term debt:* The fair values of the Group's long-term borrowings are estimated based on quoted market prices, where available. For those notes where quoted market prices are not obtainable, a discounted cash flow analysis is used based on the Group's current incremental borrowing rates for similar types of borrowing arrangements.

*Secured borrowings:* The fair values for securities sold under agreements to repurchase are estimated using discounted cash flow calculation that applies interests currently being offered for securities sold under agreements to repurchase with similar maturities. The fair values for beneficial interests issued by the SPEs estimated using quoted market price.

*Derivative financial instruments:* All derivatives are recognized on the consolidated balance sheets at fair value based on quoted market prices, dealer or counterparty quotes, where available. If quoted market prices are not available, pricing or valuation models are applied to current market information to estimate fair value.

*Redeemable convertible preferred stock:* The fair value of redeemable convertible preferred stock are estimated based on the market price of common stock of Shinhan Financial Group.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The following table sets forth the estimated fair values, and related carrying or notional amounts of the Group's financial instruments at December 31:

	2005		2006	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
(In millions of Won)				
Financial assets:				
Financial assets for which carrying value approximates fair value	W 11,089,305	W 11,089,305	W 12,890,321	W 12,890,321
Interest-bearing deposits in banks	626,771	626,771	725,191	725,191
Trading assets	4,507,043	4,507,043	4,836,892	4,836,892
Securities	25,442,795	25,459,890	25,039,492	25,149,080
Loans	104,446,954	104,569,756	120,989,101	121,328,781
Non-marketable equity investments included in other assets	1,419,127	2,603,441	1,054,994	2,584,126
Financial liabilities:				
Financial liabilities for which carrying value approximates fair value	3,780,364	3,780,364	3,476,941	3,476,941
Deposits	86,421,367	87,043,877	95,496,454	96,416,101
Trading liabilities	1,048,157	1,048,157	1,610,840	1,610,840
Short-term borrowings	11,968,300	11,968,300	10,995,026	10,995,026
Secured borrowings	7,501,707	7,547,573	8,102,714	8,111,843
Long-term debt	26,171,822	25,423,632	32,574,138	31,926,214
Redeemable convertible preferred stock	W 367,871	W 917,890	W	W

The differences between the carrying amounts and the fair values of guarantees, commercial letters of credit, standby letters of credit, and other lending commitments are immaterial to the consolidated financial statements.

**30. Derivative Instruments and Hedging Activities**

The Group enters into derivative and foreign exchange futures, forwards, options and swaps, to enable customers to transfer, modify or reduce their interest rate, foreign exchange and other market risks; it also trades these products for its own account. In addition, the Group uses derivatives as an end-user in connection with its risk management activities. Derivatives are used to manage interest rate risk relating to specific groups of on-balance sheet assets and liabilities, including investments, loans, and long-term debt. In addition, foreign exchange contracts are used to hedge the foreign currency denominated debt, net capital exposures and foreign exchange transactions.

For the years ended December 31, 2004, 2005 and 2006, the Group applied fair value hedge accounting exclusively to interest rate swap transactions with the hedged items of fixed rate debts that qualified for the short-cut method. Since the Group assumed no ineffectiveness for those transactions, no ineffective portion was recognized in the consolidated

statements of income for the years presented.

The Group enters into various types of derivative transactions in the course of its trading and non-trading activities. Futures and forward contracts are commitments to buy or sell at a future date a financial instrument, commodity or currency at a contracted price and may be settled in cash or through delivery. Swap contracts are commitments to settle in cash at a future date or dates which may range from a few days to a number of years, based on differentials between specified financial indices, as applied to a notional principal amount. Option contracts give

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

the purchaser, for a fee, the right, but not the obligation, to buy or sell within a limited time, a financial instrument or currency at a contracted price that may also be settled in cash, based on differentials between specified indices.

Derivatives may expose the Group to market risk, credit risk or liquidity risk in excess of the amounts recorded on the Consolidated Balance Sheet. Market risk on a derivative or foreign exchange product is the exposure created by potential fluctuations in interest rates, foreign exchange rates and other values, and is a function of the type of product, the volume of transactions, the tenor and terms of the agreement, and the underlying volatility. Credit risk is the exposure to loss in the event of nonperformance by the other party to the transaction where the value of any collateral held is not adequate to cover such losses. The recognition in earnings of unrealized gains on these transactions is subject to management's assessment as to collectibility. Liquidity risk is the potential exposure that arises when the size of the derivative position may not be able to be rapidly adjusted in periods of high volatility and financial stress at a reasonable cost.

**31. Commitments and Contingencies*****Legal and Tax Contingencies***

In the ordinary course of business, the Group is involved in tax and legal proceedings, claims and litigation. As of December 31, 2006, the Group has 258 pending lawsuits as a defendant (total amount: W252,761 million). In the opinion of management, based on current knowledge and after consultation with external counsel, the outcome of such matters will not have a material adverse effect on the Group's consolidated financial statements.

***Lease Commitments***

At December 31, 2006, the Group is obliged under a number of non-cancelable operating leases for premises and equipment used primarily for banking purposes. Total rent expense for the years ended December 31, 2004, 2005 and 2006 was W105,280 million, W115,920 million and W151,808 million, respectively. Pursuant to the terms of non-cancelable lease agreements pertaining to premises and equipment in effect at December 31, 2006, future minimum rental commitments under various non-cancelable operating leases are as follows:

<b>Years Ending</b>	<b>(In millions of Won)</b>	
2007	W	59,605
2008		31,389
2009		18,985
2010		13,241
2011		6,871
Thereafter		4,909
	W	135,000



In lieu of rent, certain lease agreements require the Group to advance a non-interest-bearing refundable security deposit to the landlord for the Group's use during the lease term. The amount of the advance is determined by the prevailing market rate. The Group has recorded rent expense and interest income related to these leases of W28,743 million, W28,822 million and W33,872 million on deposit balances of W924,093 million, W1,019,030 million and W1,053,346 million for the years ended December 31, 2004, 2005 and 2006, respectively. Such amounts were calculated based on the fixed interest rate for time deposits with similar maturities.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)*****Credit Commitments and Guarantees***

The following table summarizes the contractual amounts relating to unused credit commitments at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Commitments to extend credit:		
Corporate	W 46,335,824	W 55,580,067
Credit card lines	16,080,414	13,938,452
Consumer(1)	5,862,898	6,127,061
Commercial letters of credit	2,960,190	2,963,341
	W 71,239,326	W 78,608,921

*Note:*

(1) excluding credit card

Commitments to extend credit represent unfunded portions of authorizations to extend credit in the form of loans. The commitments expire on fixed dates and a customer has to comply with predetermined conditions to draw funds under the commitments. With respect to credit risk on commitments to extend credit, the Group is potentially exposed to loss in an amount equal to the total unused commitments. The majority of the Group's unfunded commitments are not guarantees under FIN 45.

Commercial letters of credit are undertakings by the Group on behalf of customers authorizing third parties to draw drafts on the Group up to a stipulated amount under specific terms and conditions. They are generally short-term and collateralized by the underlying shipments of goods to which they relate and therefore have significantly less risk.

The Group provides a variety of guarantees to its customers to enhance their credit standing and enable them to complete a variety of business transactions. The maximum potential amount of future payments represents the notional amounts that could be lost under the guarantees if there were a total default by the guaranteed parties, without consideration of possible recoveries under recourse provisions or from collateral held or pledged. Certain guarantees issued or modified after December 31, 2002 that are not derivative contracts have been recorded on the Group's consolidated balance sheet at their fair value at inception. The Group has recorded this amount in other liabilities with an offsetting entry in Other assets. As cash is received under such arrangements and applied to Other assets, the liability recorded at inception is amortized into income as commissions and fees over the life of the contract. The majority of these guarantees expire without being drawn upon. As a result, total contractual amounts are not representative of the Group's actual credit exposure.



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The table below summarizes all of the Group's guarantees under FIN 45 at December 31, 2006:

					<b>Total</b>	<b>Current</b>	<b>Amount of</b>	<b>Maximum</b>		
					<b>Notional</b>	<b>Carrying</b>	<b>Recourse</b>	<b>Potential</b>		
	<b>Expire</b>		<b>Expire After</b>		<b>Amount</b>	<b>Liability</b>	<b>or</b>	<b>Amount of</b>		
	<b>Within</b>		<b>One Year</b>		<b>Outstanding</b>	<b>Amount(1)</b>	<b>Collateral</b>	<b>Future</b>		
	<b>One Year</b>				<b>(In millions of Won)</b>		<b>Held</b>	<b>Payments</b>		
Financial stand-by letters of credit	W	221,484	W	13,173	W	234,657	W	70,180	W	234,657
Other financial guarantees		303,298		9,184		312,482		89,207		312,482
Performance letters of credit and guarantees		2,136,069				2,136,069		457,164		2,136,069
Liquidity facilities to SPEs		460,104		2,209,977		2,670,081				2,670,081
Loans sold with recourse				5,514		5,514		6,746		5,514
Guarantees on trust accounts		488,602		2,834,049		3,322,651				3,322,651
Credit derivatives		668,835		143,400		812,235				812,235
	W	4,278,392	W	5,215,297	W	9,493,689	W	623,297	W	9,493,689

*Note:*

- (1) Includes allowance for guarantees and acceptances, allowance for unfunded loan commitment and liabilities recorded under FIN. 45.

Financial stand-by letters of credit represent irrevocable obligations to pay third party beneficiaries when its customers fail to repay loans or debt instruments, which are generally in foreign currencies.

Other financial guarantees are used in various transactions to enhance the credit standing of the Group's customers. They represent irrevocable assurance, subject to satisfaction of certain conditions, that the Group will make payment in the event that the customers fail to fulfill their obligations to third parties. Such financial obligations include a return of security deposits and the payment of service fees.

Performance letters of credit and guarantees are issued to guarantee customers' tender bids on construction or similar projects or to guarantee completion of such projects in accordance with contractual terms. They are also issued to support a customer's obligation to supply specified products, commodities, maintenance or other services to third parties.

Liquidity facilities to SPEs represent irrevocable commitments to provide contingent liquidity credit lines including commercial paper purchase commitments to SPEs for which the Group serves as the administrator. The SPEs are established by clients to obtain funding from the commercial paper market or the corporate debt market by transferring assets to the SPEs. The Group has commitments to provide liquidity to the SPEs in amounts up to W2,670,081 million at December 31, 2006. Although the Group does not sell assets to these SPEs, it would be required to provide funding under the liquidity facilities in the event that the SPEs do not hold enough funds to make scheduled payments on their outstanding senior debt securities. Under the commercial paper purchase commitments, the Group is required to purchase commercial paper issued by the SPEs when enough funding is not available in the commercial paper market. The Group has limited credit exposure to these SPEs because the risk of first loss is borne by the clients or other third parties, or the SPEs are over-collateralized with the assets sold to them.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

Loans sold with recourse represent certain nonperforming loans the Group sold to Korea Asset Management Corporation (KAMCO) prior to 1999. These are accounted for as sales and derecognized from the consolidated balance sheets since control over these loans has been surrendered. The sales agreements contain a recourse liability under which KAMCO can obligate the Group to repurchase certain of these related loans if the related debtors fail to perform in accordance with specific restructuring plans. The recourse liability has no expiration date. Outstanding loans for which the Group has a recourse obligation amounted to W21,953 million and W13,769 million at December 31, 2005 and 2006, respectively. At December 31, 2005 and 2006, the Group has recorded in accrued expenses and other liabilities, W4,069 million and W1,676 million, respectively, representing its estimated obligation to repurchase the loans with recourse.

Guarantees on trust accounts represent guarantee on the Guaranteed Principal Money Trusts which require the Group to guarantee the return of the principal amount invested at the termination of a fixed term deposit. The Group manages and administers trust assets in the capacity as a fiduciary on agent behalf of its customers. Trust assets and liabilities are excluded from the consolidated financial statements of the Group, and are recorded in separate accounts from those of the Group's business. The guarantees on trusts funds qualify as derivatives under SFAS 133, and are included in trading liabilities at fair value on the Group's consolidated balance sheets with corresponding changes included in earnings. See Note 35 and 36 for further discussion related to trust accounts.

The Group enters into certain guarantee contracts that meet the characteristics of a derivative under SFAS No. 133. Such derivatives effectively guarantee the return on counterparty's referenced portfolio of assets. These credit derivatives will expire on various dates up to March 20, 2011 and have an aggregate notional amount of W812,235 million, which represents the maximum potential amount of future payments on the contracts. At December 31, 2006, these derivatives were recorded on the consolidated balance sheet at fair value of W250 million and W343 million in trading assets and liabilities, respectively.

**Pledged Assets**

The following table sets forth the primary components of assets pledged as collateral for borrowings and other purposes at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Short-term and long-term deposits	W 64	W 55
Trading securities	663,229	193,688
Available-for-sale securities	11,473,807	3,776,585
Held-to-maturity securities	1,546,167	4,983,153
Loans	2,430,559	2,372,809
Real estate	31,361	27,480
Other assets	29,910	4,672
	<b>W 16,175,097</b>	<b>W 11,358,442</b>

## **32. Concentrations of Geographic and Credit Risks**

### ***Geographic Risk***

Loans to borrowers based in Korea represented approximately 98% of the Group's loan portfolio at December 31, 2005 and 2006. Investments in debt and equity securities of Korean entities represented approximately 99% and 98% of the Group's investment portfolio at December 31, 2005 and 2006, respectively.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)*****Credit Risk***

Concentrations of credit risk arise when a number of customers are engaged in similar business activities, or activities in the same geographic region, or have similar economic characteristics that would cause their ability to meet their contractual obligations to be similarly affected by changes in economic conditions. Note 6 and Note 7 discuss the types of securities in which the Group invests. Note 8 discusses the type of loans in which the Group engages.

The Group regularly monitors various segments of its credit risk portfolio to assess potential concentration of risks and to obtain collateral when deemed necessary. Except for securities issued by KDIC, BOK and other governmental entities, no entity was responsible for 10% or more of the Group's total loans outstanding, trading assets and liabilities, available-for-sale securities, held-to-maturity debt securities or total interest and dividend income at December 31, 2005 and 2006 and for each of the three years ended on December 31, 2006.

The following table presents major products including both on-balance sheet (100% loans) and off-balance sheet (principally commitments to extend credit) exposures at December 31:

			<b>2005</b>				<b>2006</b>					
	<b>Credit</b>		<b>On-Balance</b>	<b>Off-Balance</b>		<b>Credit</b>	<b>On-Balance</b>	<b>Off-Balance</b>				
	<b>Exposure</b>		<b>Sheet</b>	<b>Sheet</b>		<b>Exposure</b>	<b>Sheet</b>	<b>Sheet</b>				
			<b>(In millions of Won)</b>									
Commercial and industrial	W	66,211,349	W	35,728,132	W	30,483,217	W	80,162,745	W	40,062,760	W	40,099,985
Other commercial		44,825,210		21,408,703		23,416,507		51,116,005		27,319,293		23,796,712
Lease financing		754,473		754,473				584,641		584,641		
Mortgage and home equity		26,142,838		25,840,334		302,504		30,525,917		30,097,346		428,571
Credit cards		33,955,266		17,874,852		16,080,414		17,862,756		3,924,304		13,938,452
Other consumer		9,801,956		4,241,562		5,560,394		26,156,408		20,457,918		5,698,490
	W	181,691,092	W	105,848,056	W	75,843,036	W	206,408,472	W	122,446,262	W	83,962,210

**33. Related Party Transactions**

A number of banking transactions are entered into with related parties in the normal course of business. These include trust accounts managed by the Group, and loans to executives, directors and affiliated parties.

***Trust Accounts***

Under the Korean Trust Law and the Korean Trust Business Act, the Group serves as trustee to the trust accounts in a trust management capacity in the normal course of business. See Note 35 for more information on trust accounts.





**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)*****Loans to Executives, Directors and Affiliated Parties***

The following table summarizes the movements in the amount of loans to executive officers, directors, director nominees, their immediate families and companies affiliated with the directors at December 31:

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>	
Loans at beginning of the year	W 213,270	W 180,697
New loans	26,660	53,473
Repayments	(59,233)	(62,407)
Loans at end of the year	W 180,697	W 171,763

The following table sets forth the outstanding balances at December 31, and the related income and expenses for the years ended December 31 for related party transactions:

	<b>2004</b>		<b>2005</b>		<b>2006</b>	
	<b>Trust</b>	<b>Executives,</b>	<b>Trust</b>	<b>Executives,</b>	<b>Trust</b>	<b>Executives,</b>
	<b>Accounts</b>	<b>Directors</b>	<b>Accounts</b>	<b>Directors</b>	<b>Accounts</b>	<b>Directors</b>
		<b>and</b>		<b>and</b>		<b>and</b>
		<b>Affiliated</b>		<b>Affiliated</b>		<b>Affiliated</b>
		<b>Parties</b>		<b>Parties</b>		<b>Parties</b>
			<b>(In millions of Won)</b>			
Loans	W	W 213,270	W	W 180,697	W	W 171,763
Accrued expenses and other assets	91,624		7,098		8,846	
Short-term borrowings	600,924		660,385		957,812	
Other liabilities	669		354		602	
Other interest income	768					
Net trust management fees	115,711		73,995		70,093	
Interest expense on short-term borrowings	16,985		17,052		28,267	
Interest on loans		6,828		3,538		3,863

It is the Group's policy to make loans available to employees and officers on terms equivalent to those at which it extends credit to unrelated parties. The Group does not customarily track or aggregate the total earnings on such loans as outstanding amounts are not material.

### 34. Segment Reporting

For management reporting purposes, the Group's business segment results are reported to management under Korean GAAP. The Group is organized into seven major business segments: retail banking, corporate banking, treasury and international business, other banking services, securities brokerage services, credit card and life Insurance. The Group's reportable segments are based on the nature of the products and services provided, the type or class of customers, and the Group's management organization, and provide the basis on which the Group reports its primary segment information:

*Retail banking* Activities within this segment include savings and demand deposits, consumer loans and mortgages of individual customers and sole proprietors with lending limits of W1,000 million or less.

*Corporate banking* Activities within this segment include loans, overdrafts, other credit facilities, deposits in foreign currencies and other foreign currency activities. The corporate banking segment's

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

**Notes to Consolidated Financial Statements (Continued)**

assets and liabilities are mainly from transactions with customers including small and medium sized private companies, publicly traded enterprises and sole proprietors with lending limits greater than W1 billion.

*Treasury and international business* Activities within this segment include Shinhan Bank's internal asset and liability management, proprietary trading in securities and derivatives, proprietary investment in security portfolios using Shinhan Bank's capital, and operation of Shinhan Bank's overseas branches.

*Other banking services* Activities within this segment include Shinhan Bank's impaired loan management, administration of Shinhan Bank and Chohung Bank operations, and operation of Shinhan Bank's overseas branches.

*Securities brokerage services* Activities within this segment include a full range of brokerage services, investment advice and financial planning to retail customers, and various investment banking services to corporate customers conducted through Good Morning Shinhan Securities.

*Credit card* Activities within this segment include processing domestic as well as overseas credit and debit card operations conducted through Shinhan.Card. The credit card segment's assets and liabilities are mainly from transactions with individual or corporate cardholders and card merchants.

*Life Insurance* Activities within this segment include Shinhan Life Insurance's providing life-insurance products and financial consulting services, by various sales distributions such as FC, TM, CM and Bancassurance (bank alliances including Shinhan Bank), which meet the needs of individual and group customers who want health insurance, whole life insurance and pension plan, etc.

Other banking services of the Group are comprised of activities of the holding company and other subsidiaries such as Jeju Bank and Shinhan Capital, none of which constitutes a separately reportable segment.

Operating revenues and expenses and interest income and expense, related to both third party and intersegment transactions, are included in determining the operating earnings of each respective segment. The provision for income tax is comprised of corporate income tax and resident tax surcharges. Income tax expenses are allocated to the respective segment based upon performance.

Transactions between the business segments are reflected on terms established by management.

The Group continuously assesses its assumptions, methodologies and reporting classifications to better reflect the nature and activities of the Group's business segments. The Group's business segments for the year ended December 31, 2006 have been changed reflecting the merger between Shinhan Bank and Chohung Bank, split-merger of Chohung Bank's credit card business with Shinhan card, and life insurance being reportable segment in 2006. The corresponding information for 2004 and 2005 has been restated.

Geographic segment disclosures have been excluded as assets and revenues attributable to external customers in foreign countries are not significant.



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The following table sets forth information about reporting segments at and for the years ended December 31:

								<b>2004</b>							
		<b>Shinhan Bank</b>								<b>Subtotal</b>		<b>U.S.</b>			
		<b>Treasury &amp; International Business</b>		<b>Other Banking Services</b>		<b>Securities Brokerage Services(1)</b>		<b>Credit Card(2)</b>		<b>Other</b>		<b>before Elimination</b>		<b>GAAP Adjusted</b>	
<b>Corporate Banking</b>															
W	787,620	W	2,944	W	319,760	W	54,043	W	935,518	W	(2,607)	W	4,048,956	W	(5,943)
	550,533		3,900,510		647,295		643,209		2,350		1,710,856		8,299,561		(5,943)
	1,338,153		3,903,454		967,055		697,252		937,868		1,708,249		12,348,517		(6,543)
	53,767		(4,811)		14,133		(4,696)		848,650		23,977		1,426,297		(1,243)
	545,677		3,829,181		688,794		642,572		396,563		508,387		8,039,826		(4,943)
	4,321		1,400		75,108		15,560		6,611		46,458		233,654		1,400
	734,388		77,684		189,020		43,816		(313,956)		1,129,427		2,648,740		(5,943)
	164,983		24,427		(22,243)		240		(2,984)		32,202		392,765		3,202
	569,405		53,257		211,263		43,576		(310,972)		1,097,225		2,255,975		(8,243)
	583,383		(126,890)		(183,499)		15,784		234,796		(1,251,948)		(831,793)		
	(35,559)		(4,493)		(2,353)		9,849		110,378		(28,056)		42,688		
W	1,117,229	W	(78,126)	W	25,411	W	69,209	W	34,202	W	(182,779)	W	1,466,870		
W	33,542,889	W	31,318,925	W	14,725,637	W	2,956,183	W	2,639,195	W	18,816,473	W	158,757,600	W	(4,943)

*Notes:*

- (1) Securities brokerage business is conducted through Good Morning Shinhan Securities.
- (2) Credit card business is conducted through Shinhan Card.
- (3) Includes eliminations for consolidation, intersegment transactions and certain differences in classification under management reporting system.
- (4) Includes extraordinary gain of W27,507 million.
- (5) Includes cumulative effect of change in accounting principle of W23,049 million.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

													<b>2005</b>	
<b>Shinhan Bank</b>														
Rate		<b>Treasury &amp; International Business</b>		<b>Other Banking Services</b>		<b>Securities Brokerage Services(1)</b>		<b>Credit Card(2)</b>		<b>Life Insurance</b>		<b>Other</b>		<b>Subtotal before Elimination</b>
													<b>(In millions of Won)</b>	
2,620	W	(226,809)	W	204,052	W	63,580	W	953,909	W	13,813	W	258,069	W	4,178,610
0,988		5,351,148		615,273		816,703		102,030		244,939		1,890,659		10,226,974
3,608		5,124,339		819,325		880,283		1,055,939		258,752		2,148,728		14,405,584
3,617		(40,352)		76,509		(3,550)		478,324		582		23,132		915,718
8,555		5,255,279		847,805		747,699		362,895		249,049		94,727		9,324,466
5,976		1,500		71,052		15,082		6,551		534		40,335		224,771
5,460		(92,088)		(176,041)		121,052		208,169		8,587		1,990,534		3,940,629
5,729		(33,602)		(105,182)		33,812		(5,224)		2,540		27,405		299,045
9,731		(58,486)		(70,859)		87,240		213,393		6,047		1,963,129		3,641,584
5,793)		(202,405)		(89,089)		(11,575)		276,554		(5,428)		(1,810,298)		(1,876,199)
6,341)		(24,479)		(17,345)		6,572		81,678		2,121		(14,240)		(26,617)
7,597	W	(285,370)	W	(177,293)	W	82,237	W	571,625	W	2,740	W	138,591	W	1,738,768
6,820	W	30,689,729	W	14,898,400	W	3,882,713	W	3,688,479	W	5,129,302	W	22,152,606	W	174,948,406



*Notes:*

- (1) Securities brokerage business is conducted through Good Morning Shinhan Securities.
- (2) Credit card business is conducted through Shinhan Card and the credit card segment in Chohung Bank.
- (3) Includes eliminations for consolidation, intersegment transactions and certain differences in classification under management reporting system.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

<b>2006</b>														
<b>Shinhan Bank</b>														
<b>Rate</b>	<b>Treasury &amp; International Business</b>		<b>Other Banking Services</b>		<b>Securities Brokerage Services(1)</b>		<b>Credit Card(2)</b>		<b>Life Insurance</b>		<b>Other</b>		<b>Subtotal before Elimination</b>	
<b>ing</b>														
<b>(In millions of Won)</b>														
42,971	W	(179,077)	W	608,577	W	66,779	W	717,696	W	227,637	W	58,664	W	4,575,019
3,138		6,136,650		1,035,394		1,258,781		1,296		2,134,346		2,436,079		13,843,933
56,109		5,957,573		1,643,971		1,325,560		718,992		2,361,983		2,494,743		18,418,952
35,887		(13,099)		(36,830)		2,578		92,021		2,314		49,291		515,376
41,850		5,596,254		1,274,417		1,173,243		430,395		2,187,251		418,108		12,844,596
5,671		3,638		89,217		15,637		12,318		6,619		28,560		266,128
72,701		370,780		317,167		134,102		184,258		165,799		1,998,784		4,792,852
33,151		104,442		89,340		37,912		(47,834)		44,265		29,230		714,232
39,550		266,338		227,827		96,190		232,092		121,534		1,969,554		4,078,620
24,388)		(634,614)		23,600		4,698		25,761		(25,608)		(2,032,033)		(2,527,540)
21,975)		(165,196)		(4,516)		9,848		120,492		16,645		13,012		(45,226)
6,813)	W	(533,472)	W	246,911	W	110,736	W	378,345	W	112,571	W	(49,467)	W	1,505,854
52,110	W	26,653,700	W	23,557,387	W	4,126,940	W	3,558,415	W	6,225,865	W	25,583,922	W	193,702,202

*Notes:*

- (1) Securities brokerage business is conducted through Good Morning Shinhan Securities.
- (2) Credit card business is conducted through Shinhan Card and the credit card segment in Chohung Bank.
- (3) Includes eliminations for consolidation, intersegment transactions and certain differences in classification under management reporting system.
- (4) Includes cumulative effect of change in accounting principle of W10,184 million.

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**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****35. Trust Accounts**

The Group offers a variety of asset management and administrative services under trust arrangements in accordance with the Korean Trust Law and the Korean Trust Business Act. In a trust management capacity, the Group is required to exercise due care in managing and preserving the trust assets. The trust accounts managed by the Group are classified into performance based trusts and guaranteed trusts in terms of the nature of the trusts, and the guaranteed trusts consist of Guaranteed Principal Money Trusts and Guaranteed Fixed Rate Money Trusts.

The Guaranteed Principal Money Trusts require the Group to guarantee the return of the principal amount invested at the termination of a fixed term deposit. Additionally, the Group guarantees a specified rate of return on the principal amount invested in Guaranteed Fixed Rate Money Trusts. Based on the Group's analysis of potential risk and reward generated from the guaranteed trusts, the Guaranteed Fixed Rate Money Trusts were consolidated in the Group's consolidated financial statements in accordance with FIN 46R. See Note 36 for further discussion on the consolidation scope of the trust accounts.

With respect to managing of the trust accounts, the Group charges investment management fees on the Guaranteed Principal Money Trusts and other performance based trusts, and receives commission income, including penalty charges for early withdrawal of fixed term deposits.

**36. Securitizations and Variable Interest Entities**

The Group primarily securitizes, sells and services corporate loans, credit card receivables, mortgage and student loans. In certain situations, the Group also provides liquidity guarantees to investors in the form of beneficial interests and standby letters of credit as discussed in Note 31.

The Group recognized net gain(loss) of W1,023 million, W94,411 million, and W(5,018) million in 2004, 2005, and 2006, respectively, related to securitizations and sale of loans in which the Group has surrendered control.

The Group may, in the normal course of its business, provide various products and services to various entities which may be deemed to be variable interest entities such as asset-backed securitization of performing and/or non-performing loans, various investment funds, guaranteed trusts and SPEs created for structured financing. The Group may provide liquidity facilities, may be a party to derivative contracts with VIEs, may provide loss enhancement in the form of credit and other guarantees to the VIEs, may be the investment manager and may also have an ownership interest or other investment in certain VIEs. In general, the investors in the obligations of consolidated VIEs have recourse only to the assets of those VIEs and do not have recourse to the Group, except where the Group has provided a guarantee to the investors or is the counterparty to a derivative transaction involving the VIE.

The following table presents the carrying amounts and classification of consolidated assets that are pledged as collateral for VIE obligations, including VIEs where the Group is the primary beneficiary:

<b>2005</b>	<b>2006</b>
<b>(In millions of Won)</b>	

Loans	W 2,008,800	W 1,922,217
Securities	4,710,614	4,715,195
Other assets	529,467	470,747
	W 7,248,881	W 7,108,159

Of the W7,248,881 million and W7,108,159 million of total assets of VIEs consolidated by the Group at December 31, 2005 and 2006, respectively, W4,810,734 million and W4,499,357 million represent structured transactions where the Group packages and securitizes assets or the Group provides credit enhancement or liquidity guarantees; W2,406,142 million and W2,550,573 million represent investment trusts that holds investments on

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

behalf of the Group; W32,005 million and W58,229 million represent the Guaranteed Fixed Rate Money Trusts constructed by the Group.

The Group consolidated its Guaranteed Fixed Rate Money Trusts because the Group was deemed to be the primary beneficiary. These trusts were constructed by the Group and the Group would absorb the majority of the expected losses of the trusts by providing a guarantee of the principal and a fixed rate of return on the principal amount in trust. The Group did not consolidate its Guaranteed Principal Money Trusts or performance based trusts because the Group was not the primary beneficiary.

In addition to the VIEs that are consolidated in accordance with FIN 46R, the Group has significant variable interests in certain other VIEs that are not consolidated because the Group is not the primary beneficiary. These VIEs are structured by other third parties. In all cases, the Group does not absorb the majority of the VIEs' expected losses nor does it receive a majority of the VIEs' expected residual returns, or both. These VIEs facilitate client transactions, and the Group provides the VIEs with administration services and liquidity. The transactions with these VIEs are conducted at an arm's length, and individual credit decisions are based upon the analysis of the specific VIE, taking into consideration the quality of the underlying assets. The Group records and reports these transactions with the VIEs similar to any other third party transactions.

The following table presents the aggregated total assets of significant variable interest entities where the Group holds a significant variable interest, but does not consolidate, and the Group's maximum exposure to loss as a result of its involvement with these entities at December 31:

	2005		2006	
	Total Assets	Maximum Exposure	Total Assets	Maximum Exposure
	(In millions of Won)			
SPEs created for structured financing	W 4,302,822	W 2,743,489	W 26,810,740	W 8,784,815
Credit enhancement provided to SPEs	13,554,109	3,055,887	12,959,520	4,402,508
Collateralized loan obligation	13,342		1,837	
Guaranteed principal money trusts	3,160,917	3,060,652	2,603,772	2,505,600
Total	W 21,031,190	W 8,860,028	W 42,375,869	W 15,692,923

As most of these liquidity facilities expire without being drawn, the total variable interest in these VIEs is not, in the Group's view, representative of the Group's actual future funding requirement.

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****37. Other Comprehensive Income**

The following table sets forth the movements of other comprehensive income, net of tax:

	<b>Foreign Currency Translation Adjustments</b>	<b>Net Unrealized Gain on Available-for- Sale Securities(1) (In millions of Won)</b>	<b>Accumulated Other Comprehensive Income</b>
<b>Balance at January 1, 2004</b>	W 6,039	W 52,057	W 58,096
Foreign currency translation adjustment, net of tax effect of W7,003	(18,462)		(18,462)
Unrealized net gain on available-for-sale securities, net of tax effect of W47,851		128,195	128,195
Less: Reclassification adjustment for net realized gain included in income, net of tax effect W3,776		9,956	9,956
<b>Balance at December 31, 2004</b>	(12,423)	170,296	157,873
Foreign currency translation adjustment, net of tax effect of W4,561	(12,024)		(12,024)
Unrealized net loss on available-for-sale securities, net of tax effect of W81,975		(220,975)	(220,975)
Less: Reclassification adjustment for net realized gain included in income, net of tax effect W9,512		25,076	25,076
<b>Balance at December 31, 2005</b>	(24,447)	(75,755)	(100,202)
Foreign currency translation adjustment, net of tax effect of W5,050	(13,315)		(13,315)
Unrealized net gain on available-for-sale securities, net of tax effect of W121,742		323,165	323,165
Less: Reclassification adjustment for net realized gain included in income, net of tax effect W63,460		(167,304)	(167,304)
<b>Balance at December 31, 2006</b>	W (37,762)	W 414,714	W 376,952

*Notes:*

(1) Equity method investments included.

**38. Subsequent Events**

On March 19, 2007, the Group acquired 98,517,316 shares or 78.6% of the issued and outstanding common stock of LG Card, currently Korea's largest credit card company, from the creditors committee of LG Card, led by Korea Development Bank. See Note 3.

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

Shinhan Financial Group Co., Ltd. (the Parent Company) was incorporated on September 1, 2001 as the holding company for Shinhan Bank and other subsidiaries. The Parent Company coordinates the activities of its various subsidiaries to offer a comprehensive line of financial services to its customers, and serves as the primary source of funding for its non-banking subsidiaries including Good Morning Shinhan Securities, Shinhan Capital and Shinhan Card.



**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

Distributions of retained earnings of Shinhan Bank and Jeju Bank are restricted in order to meet the minimum capital ratio requirements under the FSC regulations. Also, retained earnings of Shinhan Bank and other subsidiaries of the Parent Company are restricted in accordance with the Bank Act of Korea, the Korean Commercial Law and other laws.

In certain instances, the Parent Company provided guarantees to other financial institutions that provided funding to its subsidiaries. Guarantees to such other financial institutions are W50,000 million, W57,000 million and W3,500 million at December 31, 2004, 2005 and 2006, respectively.

The following table presents the cash dividends paid to the Parent Company by its subsidiaries and affiliates for the three years ended December 31:

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Won)</b>		
Cash dividends paid by:			
Consolidated subsidiaries	W 252,807	W 379,210	W 465,525
Equity method investees	3,730	4,846	5,616
	W 256,537	W 384,056	W 471,141

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

The Parent Company's condensed balance sheets as of December 31, 2005 and 2006, and the related condensed statements of income and cash flows for each of three-year period ended December 31, 2004, 2005 and 2006 are as follows:

**CONDENSED BALANCE SHEETS**

	<b>2005</b>	<b>2006</b>
	<b>(In millions of Korean Won)</b>	
<b>Assets</b>		
Deposits with banking subsidiary	W 64,374	W 468,561
Advances to, and receivables from, subsidiaries:		
Banking subsidiaries	93,140	
Non-banking subsidiaries	1,390,910	1,185,072
Investment (at equity) in subsidiaries:		
Banking subsidiaries	8,729,742	10,034,672
Non-banking subsidiaries	1,848,179	2,294,576
Premises and equipment	2,290	1,688
Other assets	159,698	684,865
<b>Total assets</b>	<b>W 12,288,333</b>	<b>W 14,669,434</b>
<b>Liabilities and stockholders' equity</b>		
Short-term debt	W 85,188	W 120,000
Long-term debt	3,860,573	4,483,724
Accrued expenses and other liabilities	163,916	86,372
<b>Total liabilities</b>	<b>4,109,677</b>	<b>4,690,096</b>
Redeemable convertible preferred stock	367,872	
Stockholders' equity	7,810,784	9,979,338
<b>Total liabilities, redeemable convertible preferred stock and stockholders' equity</b>	<b>W 12,288,333</b>	<b>W 14,669,434</b>

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****CONDENSED STATEMENTS OF INCOME**

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Korean Won)</b>		
<b>Income</b>			
Dividends from banking subsidiaries	W 244,807	W 367,210	W 428,412
Dividends from non banking subsidiaries	11,730	16,846	42,729
Interest income from banking subsidiaries	6,111	7,189	3,977
Interest income from non banking subsidiaries	108,153	88,622	75,173
Other income	19,253	4,749	19,188
<b>Total income</b>	<b>390,054</b>	<b>484,616</b>	<b>569,479</b>
<b>Expenses</b>			
Interest expense	247,711	240,609	239,115
Salaries and employee benefits	15,328	23,163	15,641
Other expense	32,490	14,400	36,154
<b>Total expenses</b>	<b>295,529</b>	<b>278,172</b>	<b>290,910</b>
<b>Income before income tax expense (benefit) and undistributed net income of subsidiaries</b>	<b>94,525</b>	<b>206,444</b>	<b>278,569</b>
Income tax expense (benefits)	46,480	(2,879)	(12,610)
<b>Income before undistributed net income of subsidiaries</b>	<b>48,045</b>	<b>209,323</b>	<b>291,179</b>
Equity in undistributed net income of subsidiaries:			
Banking subsidiaries	1,259,134	1,320,723	840,456
Non-banking subsidiaries	159,691	208,722	338,666
<b>Net income</b>	<b>W 1,466,870</b>	<b>W 1,738,768</b>	<b>W 1,470,301</b>

**Table of Contents****Shinhan Financial Group Co., Ltd. and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****CONDENSED STATEMENTS OF CASH FLOWS**

	<b>2004</b>	<b>2005</b>	<b>2006</b>
	<b>(In millions of Korean Won)</b>		
<b>Cash flows from operating activities</b>			
Net income	W 1,466,870	W 1,738,768	W 1,470,301
Less: Net income of subsidiaries	(1,675,362)	(1,913,501)	(1,650,263)
Parent Company net income (loss)	(208,492)	(174,733)	(179,962)
Depreciation on premises and equipment	763	767	857
Grant of stock options	1,988	7,087	(1,872)
Cash dividends from subsidiaries	256,537	384,056	471,141
Interest expense	42,919	29,487	28,675
Unrealized foreign exchange gain	(18,141)	(2,156)	(5,838)
Unrealized foreign exchange loss	18,132	2,156	5,838
Other assets, net (excluding assets for LG Card acquisition)	53,937	(34,905)	(6,463)
Accrued expenses and other liabilities, net	94,656	(24,422)	(38,498)
Net cash provided by operating activities	242,299	(187,337)	273,878
<b>Cash flows from investing activities</b>			
Repayments from subsidiaries	168,024	272,543	293,140
Purchases of at equity in subsidiaries	(111,894)	(368,104)	
Disposition of investment in subsidiaries		2,912	
Net change in premises and equipment	(1,706)		(87)
Increase in other assets (relating to LG Card acquisition)			(519,318)
Net cash provided by (used in) investing activities	54,424	(92,649)	(226,265)
<b>Cash flows from financing activities</b>			
Net change in short-term debt	(44,000)	35,188	34,812
Proceeds from issuance of long-term debt	246,036	780,000	2,300,000
Repayments of long-term debt	(230,921)	(635,600)	(1,700,131)
Net change in treasury stock	59	62	(29)
Cash dividends paid	(242,105)	(241,109)	(278,078)
Net cash provided by (used in) financing activities	(270,931)	(61,459)	356,574
<b>Net increase in cash and due from banks</b>	<b>25,792</b>	<b>33,229</b>	<b>404,187</b>
<b>Cash and due from banks, beginning of the year</b>	<b>5,353</b>	<b>31,145</b>	<b>64,374</b>
<b>Cash and due from banks, end of the year</b>	<b>W 31,145</b>	<b>W 64,374</b>	<b>W 468,561</b>

<b>Cash paid for interest</b>	W	204,791	W	211,122	W	210,441
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