

TSB BANKING GROUP PLC (THE 'COMPANY')
BOARD AUDIT COMMITTEE
TERMS OF REFERENCE

1. PURPOSE

1.1 The Audit Committee (the '**Committee**') is responsible for ensuring a straightforward and transparent culture exists within the Group which supports the Group's risk appetite in respect of financial risk reporting, internal control, fraud and whistleblowing. In doing so the Committee will draw the Board's attention to any concerns the Committee has in respect of the financial position or prospects of the Group.

1.2 The Audit Committee is authorised by the Board of the Company (the '**Board**') to review and report its conclusions to the Board on:

- a) the financial statements and reporting of the Group;
- b) narrative reporting of the Group;
- c) internal controls and risk management systems;
- d) whistleblowing and fraud;
- e) the Bank's internal audit function; and
- f) the Group's relationship with its external auditors.

1.3 The Committee is a committee of the Board of the Company and as such is authorised by the Board to:

- a) delegate any of its responsibilities to a sub-Committee including one established solely for that purpose;
- b) seek any information that it requires or request attendance at a meeting from any employee or director of the Company or any other member of the Group, and all employees and directors are directed to co-operate with any requests made by the Committee; and
- c) obtain outside legal or other independent professional advice in relation to matters falling within its responsibilities and to approve the fees and other terms of any such retainer.

1.4 The Committee has the right to publish in the Company's annual report, details of any issues that cannot be resolved between the Committee and the Board.

2. RESPONSIBILITIES

2.1 The Committee should carry out the duties below for the Group (including the Company and the Bank) as appropriate.

Financial Reporting

2.2 The Committee shall review and challenge the actions and judgements of management in relation to the interim and annual financial statements prior to submission to the Board, and any other formal announcement relating to the Group's financial performance (including half-year reports and interim financial statements), reviewing and reporting to the Board on significant financial reporting and judgements which they contain having regard to matters communicated to it by the auditor.

2.3 In particular the Committee shall review and challenge where necessary:

- a) the consistency of, and any changes to, significant accounting policies both on a year on year basis and across the Company/Group;
- b) the Going Concern statements included in interim and annual financial statements;
- c) the methods used to account for significant or unusual transactions where different approaches are possible;
- d) whether the Group has followed appropriate accounting standards and made appropriate estimates and judgements, taking into account the views of the external auditor;
- e) the clarity and completeness of disclosure in the Group's financial reports and the context in which the statements are made; and
- f) all material information presented with the financial statements, such as the business review and the corporate governance statements relating to audit.

2.4 The Committee will also have oversight accountability in respect of the systems and internal controls used to support the submission to the Prudential Regulation Authority of the Bank's ICAAP, ILAA and Recovery Plan (including the CFP) and for the relevant Pillar 3 disclosures, to ensure that the data is accurate and complete, working closely with the Risk Committee as required.

2.5 Where the Committee is not satisfied with any aspect of the proposed financial reporting by the Company or the Group, it shall report its views to the Board.

Narrative Reporting

2.6 When requested by the Board, the Committee shall review the content of the annual reports and accounts of any Group company and advise the Board on whether, taken as a whole, it is fair, balanced and understandable and provides the information necessary for shareholders to assess the relevant member of the Group's performance, business model and strategy.

Internal controls and risk management systems

2.7 The Committee shall:

- a) keep under review the adequacy and effectiveness of the Group's internal financial controls and internal control and risk management systems;
- b) review and approve the statements to be included in the Company's annual report and accounts concerning internal controls and risk management; and
- c) In carrying out the responsibilities in respect of internal controls and risk management systems, the Committee will receive reports on the Group's compliance from the Group's independent Risk Function, Internal Audit and the Group's External Auditor.

Whistleblowing and fraud

2.8 The Committee shall:

- a) review the adequacy and security of the Group's arrangements for its employees and contractors to raise concerns, in confidence, about possible wrongdoing in financial reporting or other matters. The Committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action;

- b) review the Group's procedures for detecting fraud; and
- c) review the Group's systems and controls for the prevention of bribery and receive reports on non-compliance.

Internal Audit

2.9 The Committee shall:

- (a) approve the appointment or termination of the Audit Director (the '**Audit Director**');
- (b) review and approve the remit of the Bank's internal audit function;
- (c) approve the internal audit budget and ensure that the function has the necessary resources and access to information to enable it to fulfil its mandate, and is equipped to perform in accordance with appropriate professional standards for internal auditors and disclose in the annual report whether it is satisfied that Internal Audit has the appropriate resources;
- (d) ensure that the Audit Director has direct access to the Board chairman and to the Committee chairman, and is accountable to the Committee;
- (e) review the annual internal audit programme and ensure that the Bank receives adequate internal audit coverage from suitably skilled auditors;
- (f) receive a report on the results of the work of the Bank's internal audit function on a periodic basis;
- (g) review and monitor management's responsiveness to any internal audit findings and recommendations;
- (h) meet with the Audit Director at least once a year without the presence of management;
- (i) monitor and review the effectiveness of the Bank's internal audit function in the context of the Group's overall risk management system; and
- (j) commission an independent external assessment of Internal Audit, in line with the Chartered Institute of Internal Auditors' Standards, at least once every five years.

External Audit

2.10 The Committee shall:

- (a) consider and, where appropriate, recommend to the Board to be put to the shareholders of the Company for approval at the Annual General Meeting, the appointment, re-appointment, resignation and dismissal of the external auditors;
- (b) ensure that at least once every ten years the audit services contract is put out to tender to enable the Committee to compare the quality and effectiveness of the services provided by the incumbent auditor with those of other audit firms; and in respect of such tender oversee the selection process and ensure that all tendering firms have such access as is necessary to information and individuals during the duration of the tendering process;
- (c) if an auditor resigns, investigate the issues leading to this and decide whether any action is required;
- (d) oversee the relationship with the external auditor including (but not limited to):
 - i. recommendations on their remuneration, including both fees for audit and non-audit services, and that the level of fees is appropriate to enable an effective and high quality audit to be conducted;
 - ii. approval of the terms of engagement of the external auditors, including any engagement letter issued at the start of each audit and the scope of the audit;

- iii. annually assess the effectiveness, independence and objectivity of the external auditors taking into account relevant professional and regulatory requirements and the relationship with the auditor as a whole, including matters related to the provision of any non-audit services;
 - iv. satisfying itself that there are no relationships (such as family, employment, investment, financial or business) between the auditor and the Group (other than in the ordinary course of business) which could adversely affect the auditor's independence and objectivity;
 - v. agreeing with the Board a policy on the employment of former employees of the Company's auditor, and monitoring the implementation of this policy;
 - vi. monitoring the auditor's compliance with relevant ethical and professional guidance on the rotation of audit partner, the level of fees paid by the Group compared to the overall fee income of the firm, office and partner and other related requirements;
 - vii. ensuring that key partners are rotated at appropriate intervals;
 - viii. assessing annually the qualifications, expertise and resources of the auditor and the effectiveness of the audit process, which shall include a report from the external auditor on their own internal quality procedures;
 - ix. seeking to ensure co-ordination with the activities of the internal audit function;
 - x. evaluating the risks to the quality and effectiveness of the financial reporting process and consideration of the need to include the risk of the withdrawal of the auditor from the market in that evaluation; and
 - xi. reviewing FRC reporting on PwC audits subject to FRC review, together with more general information available on PwC;
- (e) meet regularly with the external auditor (including once at the planning stage before the audit and once after the audit at the reporting stage), without management being present, to discuss the auditor's remit and any issues arising from the audit;
- (f) review and approve the annual audit plan and ensure that it is consistent with the scope of the audit engagement, having regard to the seniority, expertise and experience of the audit team; and
- (g) review the findings of the audit with the external auditor. This shall include, but not be limited to, the following:
- i. a discussion of any major issues which arose during the audit;
 - ii. key accounting and audit judgements;
 - iii. levels of errors identified during the audit; and
 - iv. the effectiveness of the audit process.
- (h) The Committee shall also:
- i. review any representation letter(s) requested by the external auditor before they are signed by management;
 - ii. review the external auditor's management letter and management's response to the auditor's findings and recommendations;
 - iii. develop and implement policy on the supply of non-audit services by the external auditor to avoid any threat to audit objectivity and independence, taking into account any relevant ethical guidance on the matter;
 - iv. review reports prepared by the external auditors on the Committee's request;
 - v. seek to resolve any disagreements between management and the external auditors regarding financial reporting; and
 - vi. be responsible for the co-ordination of the internal and external auditors.

COMMITTEE EFFECTIVENESS

2.11 At least annually, review the effectiveness of the Committee including specific review of the formal training undertaken or required by the Committee members to discharge their duties effectively and review the Terms of Reference of the Committee, and report to the Board thereon.

3. MEMBERSHIP AND OPERATION OF THE COMMITTEE

- 3.1** The Committee shall comprise at least three directors, all of which shall be independent non-executive directors. Membership shall include at least one member of the Risk Committee and one member who has recent and relevant financial experience in retail banking, ideally with a professional qualification from at least one of the professional accounting bodies. Members of the Committee shall be appointed by the Board, on the recommendation of the Nomination Committee, and in consultation with the Chairman of the Committee.
- 3.2** Appointments to the Committee are made by the Board and shall be for a period of up to three years, which may extend for further periods of up to three years, provided the director still meets the criteria for membership of the Committee.
- 3.3** The Board shall appoint the Committee chairman who should be an independent non-executive director. In the absence of the Committee chairman and/or an appointed deputy, the remaining members present shall elect one of themselves to chair the meeting from those who would qualify under these terms of reference to be appointed to that position by the Board.
- 3.4** The Company Secretary or his or her nominee shall act as the secretary to the Committee.
- 3.5** The quorum necessary for the transaction of business shall be two, both of whom must be independent non-executive directors.
- 3.6** Meetings of the Committee shall be called by the secretary of the Committee at the request of the Committee chairman.
- 3.7** Unless otherwise agreed, notice of the meeting confirming the venue, time and date, together with an agenda of items to be discussed, shall be forwarded to each member of the Committee, any other person required to attend and all other non-executive directors, no later than three clear working days before the date of the meeting. Supporting papers shall be sent to committee members and to other attendees as appropriate, at the same time.
- 3.8** The Committee Chairman should attend the annual general meeting to answer any shareholder questions on the Committee's activities.
- 3.9** The Committee shall be provided with appropriate and timely training, both in the form of an induction programme for new members and on an ongoing basis for all members.

4. INPUTS

4.1 The Committee will be supported by the HR, Risk, Legal and Finance functions of the Group and will have access to whatever additional advice or support it requires in the discharge of its duties. This will include but is not limited to:

- a) access to the advice and services of the HR Director and HR team;
- b) access to the advice and services of the Chief Risk Officer and the Risk team;
- c) access to the advice and services of the General Counsel and the Legal/Company Secretarial team;
- d) access to the advice and services of the Chief Financial Officer and the Finance team; and
- e) outside independent professional, technical and/or legal advice or other resources, at the Company's expense, as and when it considers this necessary.

4.2 The Committee shall have regard to established and evolving best practice corporate governance standards including, where relevant, standards set by voting agencies and voluntary codes. Where departure from the requirements of these standards or codes, including the UK Corporate Governance Code is required or believed to be appropriate, the Committee shall recommend to the Board the appropriate explanation or justification or use as required, in the Company's external disclosures.

5. OUTPUTS

5.1 The Committee Chairman shall report formally to the Board on the Committee's proceedings.

5.2 The Committee shall compile a report on its activities to be included in the Company's annual report. The report shall include an explanation of how the Committee has addressed the effectiveness of the external audit process; the significant issues that the Committee considered in relation to the financial statements and how these were addressed, having regard to the matters communicated to it by the auditor; and all other information requirements set out in the UK Corporate Governance Code.

5.3 In the compiling of the reports referred to in paragraph 5.1 and 5.2, the Committee shall exercise judgement in deciding which of the issues it considers in relation to the financial statements are significant, but should include at least those matters that have informed the Board's assessment of whether the Company is a going concern. The report to shareholders need not repeat information disclosed elsewhere in the annual report and accounts, but could provide cross-references to that information.

5.4 The secretary of the Committee shall minute the proceedings of all meetings of the Committee, including recording the names of those present and in attendance.

5.5 Draft minutes of Committee meetings shall be distributed to all members within 5 working days of the meeting. Once approved, minutes should be circulated to all other members of the Board, together with other meeting attendees, unless in the opinion of the Committee chairman it would be inappropriate to do so.

5.6 Final signed copies of the minutes of the meetings of the Committee should be maintained for the Company's records, in hard and soft copy where possible.

5.7 The Committee shall make whatever recommendations to the Board it deems appropriate on any area within its remit where action or improvement is needed.

6. NON MEMBERS/OTHER ATTENDEES

- 6.1** Only members of the Committee have the right to attend Committee meetings. However, all other independent non-executive directors have an open invitation to attend meetings.
- 6.2** The Chief Executive Officer, the Chief Financial Officer, representatives of the External Auditor and the Audit Director are expected to attend. Additionally, the Chief Risk Officer, Chief Operating Officer, General Counsel and external advisors may be invited to attend all or part of the meeting as appropriate, together with other attendees at the discretion of the Committee chairman.

7. FREQUENCY OF MEETINGS

- 7.1** Meetings shall be held as circumstances require, but at least four times a year to enable responsibilities to be discharged.
- 7.2** Outside of the formal meeting programme, the Committee chairman will maintain a dialogue with key individuals involved in the Company's governance, including the Board Chairman, the Chief Executive Officer, the Chief Financial Officer, the External Audit Partner and the Audit Director.
- 7.3** At least once a year, without the presence of executive management, the Committee shall meet with the external auditors and with the Audit Director.

8. MISCELLANEOUS

- 8.1** References in these Terms of Reference to executive positions (including, without limitation, Chief Executive Officer, Chief Financial Officer, Chief Risk Officer, HR Director, Audit Director and General Counsel) are to the individual holding that position for the Group, whether formally appointed by the Company, TSB Bank plc (the "**Bank**") or otherwise.
- 8.2** In these Terms of Reference, '**Group**' means the Company together with its subsidiaries and subsidiary undertakings from time to time (as defined in the Companies Acts 2006).