

CO-OPERATIVE BANKING GROUP

AUDIT COMMITTEE

Terms of Reference

1. Constitution

The Audit Committee (Committee) Terms of Reference were approved on 13 July 2011 by the Boards of Co-operative Banking Group, The Co-operative Bank plc, Co-operative Insurance Society Limited and CIS General Insurance Limited.

2. Membership

- 2.1 The Committee shall be appointed by the Co-operative Banking Group Board (the "Board") and shall consist of no less than four members.
- 2.2 The membership shall comprise Non-Executive Directors only.
- 2.3 The majority of members of the Committee shall be Independent Non-Executive Directors.
- 2.4 At least one member of the Committee shall have recent and relevant financial experience.
- 2.5 At least one member of the Committee shall be a member of the Risk Committee.
- 2.6 Appointments shall be for a period of up to three years, extendable by no more than two additional three-year period.
- 2.7 The Board shall appoint the Chair of the Committee.
- 2.8 The Secretary, or such person as the Secretary may recommend shall be the Secretary of the Committee and shall circulate the minutes of the meeting to the Committee and to all members of the Board.

3. Quorum

- 3.1 A quorum shall be two members.
- 3.2 A duly convened meeting of the Committee at which a quorum is present shall be competent to exercise all or any of the powers and discretions vested in or exercisable by the Committee.

4. Attendance at Meetings

- 4.1 No one other than the members of the Committee shall attend meetings of the Committee, unless at the invitation of the Chair. Such invitees may include the Chief Executive, the Chief Risk Officer, the Chief Financial Officer, the Executive, the Business

Leader Internal Audit, other senior management and the external Auditor. Other Board members may, by prior agreement with the Chair, attend as observers, and participate in a meeting, but they will not be counted towards the quorum.

- 4.2 At each meeting the Committee shall have the opportunity to meet with each of the Business Leader, Internal Audit, the external Auditor, the Chief Risk Officer and the Chief Financial Officer, without the presence of executive management to discuss any matters that any of these parties believe should be discussed privately.
- 4.3 The Chair shall communicate on a continuing basis with key individuals responsible for governance within the Co-operative Group, Co-operative Banking Group and its subsidiary undertakings.

5. Frequency of Meetings

- 5.1 Meetings shall be held no fewer than four times a year or more frequently as circumstances require.
- 5.2 The Chair of the Committee shall convene a meeting upon the request of any Committee member who considers it necessary or at the request of external or internal Auditor if they consider it necessary.

6. Authority

- 6.1 The Committee is authorised by the Board to investigate any activity within its terms of reference and seek information that it requires from any employee of Co-operative Banking Group and its subsidiary undertakings, all of whom are directed to co-operate with any request made by the Committee.
- 6.2 The Committee is authorised to engage any firm of accountants, lawyers, or other professionals, as the Committee sees fit, to provide independent advice and to assist in any review or investigation on such matters as the Committee deems appropriate.
- 6.3 The Committee is authorised to fulfil its responsibilities delegated to it by Co-operative Banking Group and also has delegated authority from the Boards of Co-operative Banking Group's subsidiary undertakings including, but not limited to, The Co-operative Bank plc, Co-operative Insurance Society Limited and CIS General Insurance Limited.

7. Responsibilities

The responsibilities of the Committee are set out below. The Committee shall carry out these duties for Co-operative Banking Group and its

subsidiary undertakings including, but not limited to, The Co-operative Bank plc, Co-operative Insurance Society Limited and CIS General Insurance Limited.

7.1 Financial Statements and Annual Reports

7.1.1 Review and discuss with management and the external Auditor the preliminary results, interim information and annual financial statements of Co-operative Banking Group and its subsidiary undertakings before submission to the respective Boards, focusing particularly on:

- the quality and acceptability of the accounting policies and practices and financial reporting disclosures and changes thereto;
- areas involving significant judgement, estimation or uncertainty;
- material misstatements detected by the Auditor that individually or in aggregate have not been corrected and management's explanations as to why they have not been adjusted;
- the basis for any ongoing concern assumption; and
- compliance with financial reporting standards and relevant financial, regulatory and governance requirements.

7.1.2 Discuss any difficulties, reservations or other matters arising from the external Auditor's review of the interim and final results (in the absence of management where necessary).

7.1.3 Review, prior to its consideration by the Board and its subsidiary undertakings, the external Auditor's report to the Directors and management's response.

7.1.4 Agree the disclosure about the role of the Committee which is included in the Annual Reports embracing the principles and guidance of the UK Corporate Governance Code to include committee membership, meeting frequency and whether external advice has been taken by the Committee.

7.2 Internal Control and Risk Management

7.2.1 Review the annual statements on internal control of Co-operative Banking Group and its subsidiary undertakings and their compliance with the UK Corporate Governance Code or subsequent corporate governance guidance (as applicable) prior to consideration by the Board and in particular, where requested by the Board to review and challenge where necessary:

- the overall process for identifying and assessing business risks and managing their impact on the organisation including Co-operative Banking Group's rating systems and its operations as required by FSA rules;

- regular assurance reports from management, internal audit, external audit, risk management, including the Controls Self Assessment process (CSA) and others on the operational effectiveness of matters related to the adequacy of controls within risk appetites;
- the timeliness of, and reports on, the effectiveness of corrective action taken by management; and
- whether the principles of the UK Corporate Governance Code or other relevant guidance have been embedded within the Co-operative Banking Group organisation.

7.2.2 Receive a report on activities and note the minutes of the Co-operative Banking Group Risk Committee (the “Risk Committee”).

7.2.3 Consider any necessary disclosure implications of the process that has been applied by the Board to deal with material internal control aspects of any significant problems disclosed in the annual reports and accounts.

7.2.4 Review arrangements by which staff may, in confidence, raise concerns about possible wrong doing in financial reporting or other matters (Whistleblowing). The Committee shall ensure that these arrangements allow proportionate and independent investigation of such matters and appropriate follow up action.

7.3 Regulatory Compliance

7.3.1 Review and approve the scope of the annual regulatory monitoring plan, taking into account the regulatory risks identified from time to time.

7.3.2 Obtain assurance that Co-operative Banking Group and its subsidiary undertakings are compliant with relevant regulation.

7.4 External Auditor

7.4.1 On recommendation of Co-operative Group Audit and Risk Committee make recommendations to the Board to be put to the members for approval at the AGM in relation to the appointment, re-appointment and removal of the external Auditor to Co-operative Banking Group and its subsidiary undertakings. If the Board does not accept the Committee’s recommendation, it should include in the Annual Report, and in any papers recommending appointment or re-appointment, a statement from the Committee explaining the recommendation and should set out reasons why the Board has taken a different position.

7.4.2 Assess the qualification, expertise, resources, effectiveness and independence of the external Auditor annually, which

shall include a report from the external Auditor on their own internal quality procedures.

- 7.4.3 Approve the terms of engagement and the remuneration to be paid to the external Auditor in respect of the audit services provided to Co-operative Banking Group and its subsidiary undertakings.
 - 7.4.4 Satisfy itself that the level of fee payable in respect of the audit service is appropriate and that an effective audit can be carried out for such a fee.
 - 7.4.5 Monitor the external audit firm's compliance with applicable UK ethical guidance relating to rotation in partners, fees in proportion to the overall fee income of the firm, office and partner
 - 7.4.6 Discuss with the external Auditor the nature and scope of the audit (including any significant ventures, investments or operations which are not subject to audit) and to ensure effective co-ordination if more than one external audit firm is involved.
 - 7.4.7 In relation to the external audit team, receive declarations annually from the external Auditor regarding any family, financial, employment, investment or business relationship with Co-operative Banking Group and its subsidiary undertakings; and their policies on maintaining their independence.
 - 7.4.8 Agree and monitor the application of the policy relating to the employment of former employees of the external Auditor.
 - 7.4.9 If the external Auditor resigns, the Committee will investigate the issues giving rise to such resignation and consider whether any action is required.
 - 7.4.10 Consider communications from the external Auditor on audit planning and findings on material weaknesses in accounting and internal control systems that came to the Auditor's attention.
 - 7.4.11 Agree and monitor the application of the formal policy for non-audit work set by Co-operative Group Audit and Risk Committee for Co-operative Banking Group and its subsidiary undertakings.
 - 7.4.12 At least once a year the Committee will meet with the external Auditor without Executive Directors or other management present.
- 7.5 Internal Audit
- 7.5.1 Approve and periodically review the terms of reference of the Internal Audit function.

- 7.5.2 Review and approve its scope of work and its annual audit plan.
 - 7.5.3 Review and discuss with the Business Leader, Internal Audit the issues identified as a result of Internal Audit work and how management is addressing these issues.
 - 7.5.4 Receive reports on management's response to audit recommendations.
 - 7.5.5 Consider and approve the remit of the Internal Audit function and ensure it has adequate resources and appropriate access to information to enable it to perform its function effectively and in accordance with the relevant professional standards. The Committee shall also ensure the function has adequate standing and is free from management or other restrictions which may impair the independence of internal audit.
 - 7.5.6 Consider issues relating to the appointment, resignation or dismissal of the senior manager(s) responsible for Internal Audit, including the Business Leader, Internal Audit.
 - 7.5.7 Review co-ordination between the internal and external Auditors and, where relevant, the risk management function(s).
 - 7.5.8 Monitor and assess the role and effectiveness of the Internal Audit function.
 - 7.5.9 Consider the major findings of any relevant internal investigations into control weaknesses, fraud or misconduct and management's response (in absence of management where necessary).
 - 7.5.10 The Chair of the Committee to approve any changes to the remuneration of the Business Leader, Internal Audit and the level of the Director's performance related bonus, as recommended by management.
- 7.6 Other Matters
- 7.6.1 Annually review and update its Terms of Reference requesting approval from the Board for all proposed changes.
 - 7.6.2 Ensure that an induction programme is provided for new members.
 - 7.6.3 Ensure that ongoing training is provided to members and to include an understanding of the principles of, and developments in, financial reporting, company law, and regulatory requirements.
 - 7.6.4 Consider other disclosures, documents or topics, as determined by Co-operative Banking Group, and its subsidiary undertakings from time to time.

- 7.6.5 Evaluate, annually, its own performance against its terms of reference and best practice.
- 7.6.6 The Chair of the Committee shall attend the Annual General Meeting and be prepared to respond to any member/shareholder questions on the Committee's activities.
- 7.6.7 These terms of reference of the Committee shall be made publicly available explaining the role and authority delegated to the Committee by the Board.
- 7.6.8 An audit calendar shall be determined to underpin compliance with the revised UK Corporate Governance Code.

8. Reporting Lines

- 8.1 The Chair of the Committee shall report on Committee business to:
 - Co-operative Group Audit and Risk Committee with such recommendations as this Committee may deem appropriate; and
 - the Board with such recommendations as the Committee may deem appropriate.
- 8.2 The minutes of the meeting shall be provided to the Board.
- 8.3 The external Auditor will issue written reports to the Board, which will be circulated in advance of the Board Meetings at which external Auditor will be in attendance (as appropriate).

9. Management Information Requirements

The Secretary of the Committee will normally circulate the agenda and papers for meetings at least seven clear days before the meeting.