

HANG SENG BANK LIMITED

TERMS OF REFERENCE OF AUDIT COMMITTEE

1 Membership

- 1.1 The Audit Committee (**the “Committee”**) shall consist of not less than three Independent Non-executive Directors of the Bank appointed by the Board.
- 1.2 The Board may from time to time appoint to the Committee additional members it has determined to be independent provided that the majority of the members of the Committee are Independent Non-executive Directors.
- 1.3 The Chairman of the Committee shall be appointed by the Board.
- 1.4 The Chairman and each member of the Committee shall be appointed for an initial term until the conclusion of their current term of appointment as a Non-executive Director. Subsequent additional terms of appointment to the Committee may be made subject to review and approval by the Board.
- 1.5 The Committee may invite any Director, executive, external auditor or other persons (including, but not limited to, the Chief Financial Officer, the Chief Risk Officer and the Head of Audit) to attend any meeting(s) of the Committee as it may from time to time consider desirable to assist the Committee in the attainment of its objective.
- 1.6 The Secretary of the Committee shall produce such papers and minutes of the Committee’s meetings as are appropriate and distribute them to all members of the Committee.
- 1.7 Following each Committee meeting, the Chairman shall report at the next Board meeting on important matters reviewed by the Committee and present a report of the Committee to the Board.

2 Meetings and quorum

- 2.1 The Committee shall meet with such frequency as it may consider appropriate (but in any event not less than four times a year) and shall present a report on its activities to the Board twice a year or as the Board may determine.
- 2.2 A quorum for meetings of the Committee shall be two.

3 Objective

- 3.1 The Committee shall be accountable to the Board and shall have non-executive responsibility for oversight of and advice to the Board on matters relating to financial reporting.

4 Responsibilities of the Committee

Without limiting the generality of the Committee's objective, the Committee shall have the following non-executive responsibilities, powers, authorities and discretions.

4.1 Key responsibilities in relation to financial reporting and audit

4.1.1 To monitor the integrity of the consolidated financial statements of the Bank and its subsidiaries (**collectively the "Group"**), the Bank's annual report and accounts, half-year report and, if prepared for publication, quarterly reports, any formal announcements relating to the aforesaid and any supplementary regulatory information, and to review significant financial reporting judgements contained in them. In reviewing the aforesaid and before submission of the same to the Board, the Committee should focus particularly on :

- (a) any changes in accounting policies and practices;
- (b) major judgemental areas;
- (c) significant adjustments resulting from audit;
- (d) the going concern assumptions and any qualifications;
- (e) compliance with accounting standards;
- (f) compliance with the Rules Governing the Listing of Securities on The Stock Exchange of Hong Kong Limited (**"Stock Exchange"**) and other legal requirements in relation to financial reporting;
- (g) regulatory guidance on disclosure of areas of special interest;
- (h) comment letters from appropriate regulatory authorities which may have a significant impact on financial reporting and other important aspects of the Bank's business and operations; and
- (i) matters drawn to the attention of the Committee by the Bank's external auditor.

In regard to the above :

- (a) members of the Committee must liaise with the Bank's Board of Directors, senior management, the external auditor and Head of Audit; and
- (b) the Committee should consider any significant or unusual items that are, or may need to be, highlighted in such reports and accounts and must give due consideration to any matters that have been raised by the Chief Financial Officer, Head of Audit, Chief Risk Officer, Company Secretary and General Counsel or the external auditor.

4.1.2 To review the financial and accounting policies and practices of the Group.

4.1.3 To review and discuss with Management the effectiveness of the Group's internal control systems relating to financial reporting and, where appropriate, to endorse the content of the statement relating to internal controls over financial reporting in the annual report for submission to the Board.

- 4.1.4 To monitor and review the effectiveness of the internal audit function; consider the major findings of internal investigations and Management's response and the internal audit plan; and ensure that the internal audit function is adequately resourced, has appropriate standing within the Group and is free from constraint by Management or other restrictions. Where applicable, the Committee shall recommend to the Board the appointment and removal of the Head of Audit.
- 4.1.5 To satisfy itself that there is appropriate co-ordination between the internal and external auditors.
- 4.1.6 To be primarily responsible for making recommendations to the Board, for it to put to the shareholders for their approval in general meeting, on the appointment, reappointment and removal of the external auditor, and shall be directly responsible for the approval of the remuneration and terms of engagement of the external auditor, and any questions of resignation or dismissal of the external auditor.
- 4.1.7 To review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant professional and regulatory requirements and reports from the external auditor on their own policies and procedures regarding independence and quality control and to oversee the appropriate rotation of audit partners with the external auditor.
- 4.1.8 To develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and, where required under that policy, to approve in advance any non-audit services provided by the external auditor that are not prohibited by the Sarbanes-Oxley Act 2002 and the fees for any such services; to report to the Board, identifying any matters in respect of which it considers that action or improvement is needed and make recommendations as to the steps to be taken. For this purpose, external auditor shall include any entity that is under common control, ownership or management with the audit firm or any entity that a reasonable and informed third party having knowledge of all relevant information would reasonably conclude as part of the audit firm nationally or internationally.
- 4.1.9 To review the external auditor's annual report on the progress of the audit, its management letter, any material queries raised by the external auditor to Management in respect of the accounting records, financial accounts or systems of control and, in each case, responses from Management. Any material issues arising which relate to the risk or internal controls (other than internal financial controls) shall be referred to the Bank's Risk Committee as appropriate.
- 4.1.10 To require a timely response to be provided to the financial reporting and related control issues raised in the external auditor's management letter.

- 4.1.11 To discuss with the Bank's external auditor their general approach, nature and scope of their audit and reporting obligations before the audit commences including, in particular, the nature of any significant unresolved accounting and auditing problems and reservations arising from their interim reviews and final audits, major judgemental areas (including all critical accounting policies and practices used by the Bank and changes thereto), all alternative accounting treatments that have been discussed with Management together with the potential ramifications of using those alternatives, the nature of any significant adjustments, the going concern assumption, compliance with accounting standards, and the Stock Exchange and legal requirements, reclassifications or additional disclosures proposed by the external auditor which are significant or which may in the future become material, the nature and impact of any material changes in accounting policies and practices, any written communications provided by the external auditor to Management, and any other matters the external auditor may wish to discuss (in the absence of Management where necessary).
- 4.1.12 To review and discuss the adequacy of resources, qualifications and experience of staff of the Bank's accounting and financial reporting function, their training programmes and budget and succession planning for key roles throughout the function.
- 4.1.13 To consider any findings of major investigations of internal control over financial reporting matters as delegated by the Board or on the Committee's initiative and assess Management's response.
- 4.1.14 To receive an annual report, and other reports from time to time as may be required by applicable laws and regulations, from the Chief Executive and the Chief Financial Officer to the effect that such persons have disclosed to the Committee and to the external auditor all significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which could adversely affect the Bank's ability to record and report financial data and any fraud, whether material or not, that involves Management or other employees who have a significant role in the Bank's internal controls over financial reporting.
- 4.1.15 To provide to the Board such assurances as it may reasonably require regarding compliance by the Bank, its subsidiaries and those of its associates for which it provides management services with all supervisory and other regulations to which they are subject.
- 4.1.16 To provide to the Board such assurance as it may reasonably require regarding the reliability of financial information submitted to it.
- 4.1.17 To review arrangements by which employees of the Bank may, in confidence, raise concerns about possible improprieties in financial reporting, internal control or other matters. The Committee should ensure that proper arrangements are in place for the fair and independent investigation of such matters and for appropriate follow-up action.

- 4.1.18 To report any significant actual, suspected or alleged fraud (involving misconduct or unethical behaviour related to financial reporting) or misrepresentation of assets, which has not been included in a report submitted by Management to the Committee, to the HSBC Group Chief Risk Officer and HSBC Group Finance Director.
- 4.1.19 To agree with the Board the Bank's policy for the employment of the former employees of the external auditor and monitor the application of such policies.

4.2 General matters

- 4.2.1 The Committee shall meet alone with the external auditor and with the Head of Audit at least once each year to ensure that there are no unresolved issues or concerns.
- 4.2.2 To review the composition, powers, duties and responsibilities of other non-executive audit committees within the Group where applicable. The HSBC Group Audit Committee will review the core terms of reference for adoption by such committees and approve material deviations from such core terms.
- 4.2.3 To consider other topics as defined by the Board and undertake on behalf of the Chairman or the Board such other related tasks as the Chairman or the Board may from time to time entrust to it.
- 4.2.4 The Committee may appoint, employ or retain such professional advisors as it may consider appropriate. Any such appointment shall be made through the Secretary to the Committee, who shall be responsible for the contractual arrangements and payment of fees by the Bank on behalf of the Committee.
- 4.2.5 To review annually the Committee's terms of reference and its own effectiveness and recommend to the Board any necessary changes.
- 4.2.6 To report to the Board on the matters set out in these terms of reference.
- 4.2.7 To provide half-yearly certificates to the HSBC Group Audit Committee, or to any audit committee of an intermediate holding company in the form required by the HSBC Group Audit Committee. Such certificates are to include a statement that the members of the Committee are independent.
- 4.2.8 The Committee may consider any matter relating to, and may request any information as it considers appropriate, from any audit committee, risk committee or other committee which has responsibility for the oversight of risk within the Group.

- 4.2.9 Where there is a perceived overlap of responsibilities between the Bank's Audit Committee and the Bank's Risk Committee, the respective Committee Chairmen shall have the discretion to agree the most appropriate Committee to fulfil any obligation. An obligation under the terms of reference of the Bank's Audit Committee or the Bank's Risk Committee will be deemed by the Board to have been fulfilled providing it is dealt with by either the Bank's Audit Committee or the Bank's Risk Committee.
- 4.2.10 Where the Committee's monitoring and review activities reveal cause for concern or scope for improvement, it shall make recommendations to the Board on action needed to address the issue or to make improvements and shall report any such concerns to the HSBC Group Audit Committee and/or HSBC Group Risk Committee as appropriate, or to any audit and/or risk committee of an intermediate holding company as appropriate.

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