

## NATIONAL BANK OF CANADA

### AUDIT AND RISK MANAGEMENT COMMITTEE

The Audit and Risk Management Committee (the “Committee”) is created by the Board of Directors (the “Board”) of the National Bank of Canada (the “Bank”). It oversees the work of the internal auditor and the independent auditor, supervises the financial reporting and analysis process, ensures the corporate compliance of the Bank and supervises its internal controls, its risk management, its capital, liquidity and funding management, the approval of credit facilities, the evaluation and assessment of credit risk, and the program to combat money laundering and terrorist financial activities and oversees the measures and complaints relating to consumer protection.

#### MANDATE

#### CREATION

1. The Committee is created by the Board of the Bank.

#### COMPOSITION

2. **Composition** – The Committee is composed of no less than three members. Each of the Committee members is “financially literate” within the meaning of *Regulation 52-110 respecting Audit Committees*.

3. **Eligibility** – A majority of the members of the Committee consists of directors who are not affiliated with the Bank in accordance with the *Bank Act* (the “Act”).

4. **Independence** – Each of the members of the Committee is independent as defined by the Canadian Securities Administrators.

5. **Guests** – The Chairman of the Board may attend each of the meetings of the Committee, as a guest. The Committee may invite any other person it deems necessary or desirable to attend all or part of the meetings of the Committee.

#### 6. Appointment and Vacancy

a) **Appointment** – Each member of the Committee is designated annually by the Board from among the Directors of the Bank.

b) **Term of Mandate** – All members carry out their duties until a successor is appointed, unless they resign, are relieved of their duties or no longer sit as Directors.

c) **Vacancy** – A vacancy on the Committee is filled by the Board as it deems appropriate. Failure to fill a vacancy does

not invalidate the decisions of the Committee, provided there is quorum.

#### 7. Chair

a) **Appointment** – The Chair of the Committee is designated by the Board from among the members of the Committee. If the designated Chair is unable to chair a meeting of the Committee, the Committee selects a Chair from the members of the Committee present for that meeting.

b) **Duties** – The duties of the Chair of the Committee are set out in the mandate of the Chair. The Chair of the Committee may ask the Chairman of the Board to have certain matters for which the Committee is responsible submitted to the Board.

8. **Secretary** – The Secretary of the Bank, an Assistant Secretary, or any other person designated by the Secretary, acts as Secretary of the Committee.

#### MEETINGS AND CALLING OF MEETINGS

9. **Regular Meetings** – Committee meetings are held on the dates and at the times and locations established by the Board, at least once per quarter. The Committee members are informed annually in writing thereof, without any further notice required.

10. **In Camera Meetings** – The Committee members are scheduled to meet, without any members of the Bank’s management being present, at each Committee meeting under the direction of the Chair of the Committee.

#### 11. Unscheduled Meetings

a) **Meetings** – An unscheduled meeting may be called at any time by the Chair of the Committee, the Chairman of the Board, the President and Chief Executive Officer, one of the Committee members, the Senior Vice-President – Internal Audit, the Chief Financial Officer and Executive Vice-President – Finance and Treasury, the Executive Vice-President – Risk Management, the Senior Vice-President – Finance, Taxation and Investor Relations, the Chief Compliance Officer of the Bank or by the independent auditor.

b) **Notices** – A notice specifying the purpose, place, date and time of each unscheduled meeting must be sent to each Committee member by mail or any other means of telephone or electronic communication, no less than 24 hours before the time and date set for the meeting, unless the Chair of the Committee, the Chairman of the Board or

the President and Chief Executive Officer deems it necessary to call a meeting on shorter notice, in which case notice shall be no less than two hours.

c) **Without Notice** – Unscheduled Committee meetings may be held without notice when all Committee members are present or when the absent members provide a written waiver of notice of a meeting. Moreover, the presence of a member constitutes a waiver of this notice of a meeting, except if this member is present to specifically oppose the review of any question claiming that the meeting was not called in due form.

**12. Means of Communication** – Meetings of the Committee may be held by telephone or any other means that enables all participants to communicate with each other adequately and simultaneously. Persons participating in a meeting by telephone or any other means of communication are deemed to have attended the meeting.

**13. Independent Auditor and Internal Auditors** – The independent auditor and internal auditors are entitled to receive the notices calling meetings of the Committee, to attend the audit portion thereof and to be heard at such meetings.

#### ***QUORUM***

**14. Principle** – Quorum of a Committee meeting is attained when a majority of the Committee members attend such meeting.

**15. Duration** – Quorum shall be maintained for the entire meeting so that the Committee members can legitimately deliberate and make decisions. However, any director who is not present at any particular time during the meeting for the purposes of subsection 182(3) of the Act shall be considered as attending for the purposes of quorum.

**16. Vote** – Notwithstanding the foregoing, the decisions made by the Committee concerning matters submitted for its consideration shall be made by a majority vote of the members present. Should only two members be present and quorum be attained, decisions shall be unanimous.

**17. Absence of Quorum** – If quorum is not attained at a meeting of the Committee, the Chairman of the Board may, at the request of the Chair of the Committee, act as a member of the Committee for that meeting and have a right to vote.

#### ***MINUTES***

**18. Recording** – The minutes of each meeting of the Committee, duly approved by the Committee, are entered by the Secretary in a register kept specifically for that purpose.

**19. Distribution** – The minutes of each Committee meeting are submitted for information to the members of the Board at a subsequent meeting of the Board.

**20. Report to the Board** – The Chair of the Committee makes an oral report on the deliberations of each meeting of the Committee and the recommendations of said Committee at a subsequent meeting of the Board.

#### ***ROLES AND RESPONSIBILITIES***

##### **Internal Audit**

**21. Responsibilities** – The Committee:

a) **Mandate and Annual Audit Plan** – Reviews and approves, annually, the mandate, and the nature and scope of the work of Internal Audit, as well as its annual audit plan, and ensures that the function has the necessary resources to fulfill its mandate and responsibilities;

b) **Reports** – Reviews the Internal Audit report, discusses the main audit reports and ensures that the necessary steps are taken to follow up on important report recommendations;

c) **Independence and Effectiveness** – Ensures the independence and effectiveness of Internal Audit, including by requiring that the function be free of any influence that could adversely affect its ability to objectively assume its responsibilities, by ensuring that it reports to an appropriate line level, and by meeting regularly with the Senior Vice-President – Internal Audit without management being present in order to discuss, in particular, the questions she raises regarding relations between Internal Audit and the Bank's Management and the access to the information required; and

d) **Performance, Appointment and Dismissal** – At least once a year, assesses the overall performance of the Internal Audit function, and assesses the performance of and participates in determining the compensation of the Senior Vice-President – Internal Audit; takes cognizance of the recommendations of the President and Chief Executive Officer of the Bank with respect to the appointment or dismissal of the Senior Vice-President – Internal Audit and makes the appropriate recommendations to the Board thereon.

##### **Independent Auditor**

**22. Responsibilities** – The Committee:

a) **Appointment and Compensation** – Submits to the Board its recommendations with regard to the Candidates for independent auditor proposed by the Board to the

shareholders. Submits to the Board its recommendations with regard to the compensation of the independent auditor or its dismissal and confirms the nature and scope of its mandate;

b) **Independence** – Obtains guarantees with regard to the independence of the auditor;

c) **Assessment of Overall Performance** – At least once a year and before the independent auditor tables its report on the annual financial statements, formally assesses the effectiveness and contribution of the independent auditor, including its competencies, support and communication skills. Takes into account the opinion of the Bank's Management and the Senior Vice-President – Internal Audit in order to assess the overall performance of the independent auditor for all services;

d) **Assessment and Rotation of the Partner Responsible for the Audit Mandate** – Reviews and assesses the competencies, performance and independence of the partner of the independent audit firm responsible for the audit at the Bank and his team, and discusses the appropriate time and procedure for rotating the partner, concurring partners and all other partners who are active members of the audit team;

e) **Hiring Policies** – Reviews and approves the Bank's hiring policies regarding partners, employees and former partners and employees of the present and former independent auditor of the Bank;

f) **Audit Plan** – Takes cognizance of the annual audit plan prepared by the independent auditor in order to ensure that the scope of the plan is adequate, namely, that the plan is risk-based and addresses the most important issues. Together with the independent auditor, the Committee reviews all the key changes to the plan. Ensures that it is satisfied with the engagement letter of the independent auditor;

g) **Auditor's Report** – The independent auditor of the Bank report directly to the Committee and report to the Board and Committee as representatives of the shareholders including to present, via a letter, the main recommendations concerning internal controls;

h) **Oversight** – Oversees the work of the independent auditor to issue an opinion on the Bank's consolidated financial statements based on their audit or to perform other audit, review or attest services for the Bank, including the review of the interim consolidated financial statements and the resolution of disagreements between Management and the independent auditor regarding financial reporting;

i) **Compliance of Financial Statements and Other Financial Information** – (i) Discusses with the independent auditor the quality of the financial statements and ensures that the financial statements present fairly the financial position, results of operations and the cash flows of the Bank; (ii) Meets with the independent auditor and Management to discuss the results of the audit, the interim and annual consolidated financial statements, any ancillary documents, the report or any concern of the auditor, the documents required by the Office of the Superintendent of Financial Institutions or investments or transactions that could adversely affect the financial well-being of the Bank brought to the Committee's attention; (iii) Discusses with the independent auditor the quality and acceptability of the accounting principles applied in preparing the consolidated financial statements; (iv) Reviews the annual management letter from the independent auditor of the Bank and follows up on the corrective action taken by Management; and (v) Obtains all important correspondence between the independent auditor and Management about audit findings;

j) **Meetings with the Auditor** – Meets regularly with the independent auditor of the Bank without Management being present to understand all questions that might have been raised by the auditor with Management during the audit and how those questions were resolved, and reviews any questions that could be raised by the independent auditor;

k) **Practices and Independence of Independent Auditor** – At least once a year, obtains and reviews a report by the independent auditor which explains: (i) its internal practices concerning quality control; (ii) all the important questions stemming from its most recent review of quality controls, or the latest control by peers, or following investigations carried out by professional or government authorities in the previous five years regarding one or more of its mandates and the measures taken regarding these questions; (iii) the internal procedures that the independent auditor takes to ensure its independence; and (iv) the details concerning the business relationship it has with the Bank; and

l) **Prior Approval of Mandates Given to the Independent Auditor** – Provides prior approval of mandates given to the independent auditor in accordance with the guidelines relating to mandates to the independent auditor (the "Guidelines"), including the mandates for all non-audit services. To that effect, the Committee adopts a policy and specific procedures for the engagement of the independent auditor to perform non-audit services and ensures that the conditions in these policies and procedures are met. The Committee may delegate this approval authority to one of its members. The member of the Committee to whom this approval authority is delegated must present any decisions to the Committee at the next scheduled meeting.

## Financial Reporting and Analysis

### 23. Responsibilities – The Committee:

a) **Financial Information** – Reviews the annual consolidated financial statements of the Bank and the related independent auditor’s report, the interim consolidated financial statements of the Bank, the annual and interim Management’s Discussion and Analysis, the Annual Information Form, press releases concerning material financial information, audit processes and management information systems and all other material financial information, in order to ensure their integrity, the effectiveness of processes and compliance with applicable accounting standards. The Committee recommends the approval thereof to the Board before the statements are publicly disclosed;

b) **Accounting Standards** – Asks Management and the independent auditor about changes to Canadian accounting standards that could have an impact on the preparation and/or disclosure of the consolidated financial statements of the Bank and those of its subsidiaries and informs the Board thereof, if applicable;

c) **Dispute, Notice of Assessment or Any Other Claim** – Takes cognizance of any oral or written report from Management on any dispute, notice of assessment or any other claim of a similar nature which could have a material impact on the financial position of the Bank, and ensures that such material claims are properly disclosed in the consolidated financial statements;

d) **Certification** – Reviews the process whereby the Chief Executive Officer and the Chief Financial Officer certify the integrity of the interim and annual financial statements of the Bank and other information for which certification is required;

e) **Public Disclosure** – Ensures that adequate procedures are in place to oversee the Bank’s public disclosure of financial information extracted or derived from its consolidated financial statements and periodically assesses the adequacy of those procedures; and

f) **Investments and Transactions** – Reviews such investments and transactions that could adversely affect the financial well-being of the Bank whenever the independent auditor, Internal Audit or any member of Management brings them to the Committee’s attention.

## Corporate Compliance

### 24. Corporate Compliance at the Bank and its subsidiaries – The Committee:

a) **Mandate** – Reviews, on an annual basis, the mandate and the nature and scope of the work of Corporate Compliance at the Bank and its subsidiaries including National Bank Financial Inc. and National Bank Financial Ltd. and ensures that the function has the necessary resources to carry out its mandate and responsibilities;

b) **Appointment** – Takes cognizance of the recommendations of the President and Chief Executive Officer of the Bank and its subsidiaries with respect to the appointment or dismissal of the Chief Compliance Officer of the Bank, and makes the appropriate recommendations to the Board thereon;

c) **Performance** – Annually assesses the overall performance of Corporate Compliance and that of the Chief Compliance Officer of the Bank and makes the appropriate recommendations to the Board thereon;

d) **Independence and Effectiveness** – At least once a year, ensures the independence and effectiveness of the Bank’s Corporate Compliance Department, in particular by requiring that the function be free of any influence that could adversely affect its ability to objectively assume its responsibilities and ensuring that it reports to an appropriate line level, and by ensuring that the sector has direct access to the Chair of the Committee and the President and Chief Executive Officer of the Bank and has access to the information required;

e) **Report and Status of Compliance** – Reviews, on an annual basis, the legislative compliance program and recommends approval thereof to the Board. Reviews the annual and interim reports, the status of compliance and any other report of the Chief Compliance Officer of the Bank and its subsidiaries on the status of compliance of the Bank and its subsidiaries with applicable legislation and regulations and other obligations. Obtains reasonable assurance that the Bank and its subsidiaries have the policies, programs, procedures, structures and management systems required to comply with legislation, regulations, guidelines, codes of conduct that govern them, including those of the Office of the Superintendent of Financial Institutions, and that these are operational and aligned with sound industry practices. Reports to the Board on the status of compliance, the compliance program and policies, as applicable. Follows up on questions raised and ensures that actions are taken with regard to important recommendations;

f) **Monitoring** – Asks Corporate Compliance about significant changes in laws and regulations, industry compliance issues, new trends and regulatory risks. Asks Management about material changes introduced by organizations such as the Office of the Superintendent of

Financial Institutions, the Toronto Stock Exchanges or the Canadian Securities Administrators; and

g) **Report on irregularities** – Reviews, as necessary, the report of Corporate Compliance on the irregularities or concerns related to accounting or auditing matters at the Bank that have been reported to the Ombudsman of the Bank, as well as the results of any related investigation. Examines the number of reported irregularities or concerns, whether or not they are founded.

### Internal Control

25. **Responsibilities** – The Committee:

a) **Procedures** – Requires Management to implement and maintain appropriate internal control procedures and, at least once a year, reviews, evaluates and approves such procedures; and

b) **Effectiveness** – Reviews the effectiveness of the internal control policies and procedures of the Bank. Ensures that Management diligently applies measures to correct all important control problems identified during this review and that a process is implemented to track progress in order to correct deficiencies.

### Risk Management

26. **Responsibilities** – The Committee:

a) **Mandate** – Reviews, on an annual basis, the mandate of Risk Management, approves changes it deems appropriate and ensures that the function has the resources needed to fulfill its mandate and responsibilities and maintain its independence, including by requiring that the function be free of any influence that could adversely affect its ability to objectively assume its responsibilities and ensuring that it reports to an appropriate line level;

b) **Effectiveness and Performance** – Annually assesses the effectiveness and overall performance of Risk Management;

c) **Overall Risk Philosophy** – Annually reviews and approves the principles, statements, measures and overall targets for the Bank's risk appetite, and recommends their adoption to the Board. Requires that Management implement adequate risk management strategies;

d) **Strategic Decisions** – Reviews the risks resulting from the Board's strategic decisions and advises the Board on these questions. Includes in its reviews of the changes in strategies or new business initiatives, a review of requisite or related changes in risk management and controls;

e) **Investments** – Reviews the investments and transactions that could adversely affect the Bank's profitability. Approves major strategic and non-strategic investments based on approval authority defined in the current policies;

f) **Policies** – Reviews and recommends to the Board the adoption of policies for managing significant risks which comply with the principles, statements, measures and overall targets for the Bank's risk appetite. The Committee ensures that these policies are implemented and reviews them at least once a year;

g) **Business Continuity Management Program** – Reviews and approves the Business Continuity Management Program of the Bank and its subsidiaries;

h) **Interim Reports** – Examines the interim reports by Risk Management on:

- the status of credit, market, liquidity and operational risk at the Bank;
- the model and quantification of the Bank's general allowance;
- changes in work related to operational and reputation risk management (quantitative and qualitative);
- the status of compliance to different policies and limits that are established regarding managing the following risks:
  - operational;
  - credit;
  - market;
  - outsourcing;
  - reputation risk resulting from complex structured finance transactions,

in order to identify material risks, new problems and trends, and to check compliance with policies adopted by the Bank and the Committee; and

i) **Proactive Risk Detection, Assessment and Management** – Requires that Management report to the Committee on the existence at the Bank of a process for proactively detecting, assessing and managing material risks and on compliance with policies and control measures, and reports thereon to the Board.

### Capital, Liquidity and Funding Management

27. **Responsibilities** – The Committee:

a) **Principle** – Ensures that it understands the Bank's capital, liquidity and funding needs;

b) **Capital** – Ensures that Management adopts an Internal Capital Adequacy Assessment Process. Reviews and recommends to the Board the approval of all new capital models and any major change to a capital model;

c) **Policies** – Reviews and recommends to the Board the adoption of liquidity and funding management and capital management and stress testing policies, including the approval of capital stress testing scenarios. Ensures that these policies are implemented and reviews them at least once a year;

d) **Reporting** – Requires that Management report to the Committee on the existence at the Bank of capital, liquidity and funding management processes and on compliance with policies and control measures, and reports thereon to the Board;

e) **Capital Plan** – At least once a year, reviews and recommends to the Board the adoption of a capital plan (including the Internal Capital Adequacy Assessment Process);

f) **Capital Contingency Plan** – At least once a year, reviews and recommends to the Board the adoption of a capital contingency plan; and

g) **Reports** – Reviews the reports submitted to it regarding capital management, capital adequacy assessment and stress testing.

## Credit

**28. Responsibilities** – The Committee:

a) **Delegation** – Subject to paragraph d) below, approves the credits of clients, by borrower and by group of borrowers, that exceed the powers delegated to members of the Bank's Management and which are defined in the Credit Risk Management Policy of the Bank;

b) **Related Party** – Reviews and recommends to the Board, when required by the Act, the approval of any transaction between the Bank or any of its subsidiaries and a related party as defined in the Act, except transactions allowed pursuant to the provisions of the Act and the Policy Governing the Management and Monitoring of National Bank of Canada Related Party Transactions;

c) **Impaired Loans** – Reviews changes in impaired loans and credit losses on a quarterly basis, ensures that they are monitored and approves the taking of provisions for any impaired loan in accordance with the rules set forth in the Bank's Credit Risk Management Policy;

d) **Uncommitted Credit Facilities** – Approves the uncommitted credit facilities of financial institutions, governments, corporations and other similar Canadian or foreign borrowers, arranged by the Bank, which exceed the loaning limits of members of the Bank's Management, for internal control purposes; and

e) **Reports** – Reviews reports analyzing the economic situation of a given sector of activity in which the Bank has a certain exposure and reviews portfolio limits in this sector of activity based on Management's recommendations.

## Combating Money Laundering and Terrorist Financing Activities

**29. Responsibilities** – The Committee:

a) **Appointment** – Appoints a designated officer to be responsible for applying the program to combat money laundering and terrorist financing activities ("MLTFA") at the Bank and its subsidiaries. The title of this designated officer is the Chief Anti-Money Laundering Officer;

b) **Annual Self-assessment** – Ensures that the designated officer establishes an annual self-assessment program to evaluate the effectiveness of anti-MLTFA procedures adopted by the Bank and to suggest corrective measures for risk management systems, if necessary, and requires that the designated officer draft a report on the annual self-assessment which includes the following information: a summary of the assessment's findings, the main elements of anti-MLTFA policies and procedures, and the level of adherence to them;

c) **Policies and Procedures** – Approves the Bank's anti-MLTFA policy and ensures that the policy enabling the Bank to meet its obligations to detect and deter MLTFA are developed, applied, monitored and reviewed;

d) **Independent Control System** – At least every two years, requires the Internal Audit to evaluate the implemented independent controls, in order to ensure the efficiency of the procedures allowing the Bank to respect its obligations to detect and deter MLTFA and to present a report regarding the independent controls carried out, in which, if applicable, the gaps, as well as the actions having been taken or will be taken to fill in these gaps, are described briefly.

## Credit Risk Assessment and Evaluation

**30. Responsibilities** – The Committee:

a) **Policies** – Ensures that rigour and discipline are incorporated into risk management policies, operational controls and credit risk reports and reports thereon to the Board;

b) **Systems** – Reviews and recommends all material aspects of risk rating systems and related parameters to the Board for approval; and

c) **Reports** – Receives, at least once a year, a report on the efficiency of the Bank's risk rating systems and related parameters and reports thereon to the Board.

**31. Measures and Complaints Relating to Consumer Protection** – The Committee establishes a policy and procedures for (i) the receipt, retention and treatment of complaints received by the Bank regarding accounting, internal accounting controls or auditing matters; and (ii) the confidential, anonymous submission by any person of concerns regarding questionable accounting or auditing matters. Ensures that this policy is implemented and reviews it annually.

#### **VARIA**

**32. Duties as Intermediary** - The Committee acts as intermediary between the Board and the independent oversight functions which include Internal Audit, independent audit and Corporate Compliance and ensures cooperation between Internal Audit and the independent auditor;

**33. Engagement of Independent Consultants** - The Committee may, when it deems appropriate, engage legal counsel or other independent consultants to carry out its duties and responsibilities. The Committee sets the remuneration and compensates the independent consultants it engages. The Bank provides the funds necessary to pay for the services of these independent consultants.

**34. Power of Inquiry** - The Committee may inquire about any question it deems relevant and, to that end, has complete access to the books, registers, facilities, Management and employees of the Bank.

**35. Superintendent** – The Committee meets with representatives of the Office of the Superintendent of Financial Institutions at the request of that organization and reports on such meetings to the Board.

**36. Communication** - The Committee may communicate directly with the independent auditor, the Senior Vice-President – Internal Audit, the Chief Financial Officer and Executive Vice-President – Finance and Treasury, the Executive Vice-President – Risk Management, the Senior Vice-President – Finance, Taxation and Investor Relations, the Chief Compliance Officer, and any other member of Management or employee of the Bank.

**37. Board Meeting** - The Chair of the Committee may call a meeting of the Board to discuss matters of interest to the Committee.

**38. Certifications, Declarations and Reports** – The Committee examines the certifications, declarations and/or reports required by a regulatory authority and that fall within the Committee's purview, and recommends the approval thereof to the Board.

**39. Subsidiaries** – The Committee may act as an audit and risk management committee for Natcan Trust Company and, if necessary, for any other subsidiary of the Bank where allowed under its incorporating act, and exercise all the duties incumbent upon such committee in accordance with the *Trust and Loan Companies Act* (Canada) or any other applicable legislative or regulatory provision.

**40. Assessment** – The Committee regularly assesses and reviews its mandate by submitting the revised text, for approval, to the Conduct Review and Corporate Governance Committee which then recommends it for approval to the Board.

**41. Other Duties** – The Committee shall exercise any other duty required under the applicable legislation or regulations or that the Board occasionally assigns to it. The Committee submits to the Board all recommendations it deems appropriate with respect to matters that fall within its purview.

**42. Review of Documents and Various Recommendations** – The Committee reviews any document designated by the Superintendent of Financial Institutions, any document required pursuant to applicable laws and the recommendations made by regulatory authorities or the internal or independent auditor and reports thereon to the Board.

APPROVED BY THE AUDIT AND RISK MANAGEMENT COMMITTEE ON OCTOBER 26, 2011.

APPROVED BY THE CONDUCT REVIEW AND CORPORATE GOVERNANCE COMMITTEE ON OCTOBER 27, 2011.

APPROVED BY THE BOARD OF DIRECTORS ON OCTOBER 27, 2011 AND ENTERED INTO FORCE ON NOVEMBER 1, 2011.