Question and Answer

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

Thank you. Thank you, Jon. We'll be taking questions from analysts and investors only. For those in the room, please state your name and the organization you represent and just wait for a microphone. Let's start with the room first.

Jonathan Mott
UBS Investment Bank, Research Division

Jon Mott from UBS. I've got a question. It's on the average balance sheet. So if I can get you to flip to Page 32 of the 4E, I think you might have that if you got in front. While you're flipping there, one number that stood out to me was the yield on the retail deposits in the half. And if you go through from the first half, the yield was 2.33. It actually rose in the second half to 2.35. So if you compare it to the cash rate, I know you've had a difficult year with the RBA write-down. But the average cash rate fell 20 basis points, but the yield on the deposit book actually rose. Anthony, you talked about that a lot. There's a lot of competition, especially in term deposits. But are we now at a stage where you can't really get the yield on your deposits down much more while continuing to grow your book and make the net stable funding ratio, in which case, you're going to have a lot of problems with your margins if competition on the asset side continues to increase -- or continues. Also, if the RBA cuts rates again, there's effectively -- are we now at a floor on deposits, which puts you in a pretty difficult position for your margin?

Jon Earle Sutton
Former MD, CEO & Executive Director

I think you've exceeded what you did last year, Jon. I think you've asked a 9-part question. And last year was 8. So I might just deal with the outlook on deposits and what we're actually seeing. In fact, in the last 1.5 weeks, we've actually seen a moderation in those term deposit rates across some parts of the curve, particularly that 12-month part of the curve, and also in the 24-month part of the curve. So we've actually seen the industry start to bring those deposit rates down. It's an interesting question that you pose about where the industry will go, along with if there's further RBA rate cuts. And we're not immune to that. And we'll see where the industry moves with that. And again, it's hypothetical whether the RBA will cut or not cut. But certainly, from our perspective, we're doing a lot of work on data analytics. We're doing a lot of work on demand and where we see demand for deposits in various parts of the curve and we're responding to that. And we believe that over time, that we'll be actually able to manage both sides of the balance sheet, in particular on the deposit side, because we do have a lot of deposits, to make sure that we remain competitive but also to manage that margin and fight for every single basis point.

Anthony Rose
Executive Officer

I think that answers the question.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

Any other questions in the room?

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

It's Ed Henning from CLSA. Just on the non-interest income, you talk about you're going to work hard to deliver a flat profile going forward. You've said the insurance income has kind of normalized so you don't really have a headwind from that. Obviously, that leaves you trading, your banking fees and the other. Can you just run through what are the headwinds that you -- I know you did have some realization of your BOQ Specialist assets in there. Is that the headwind? Obviously -- although you're growing, you plan to go potentially below system, you're still growing your book. So just run through what are the headwinds there for us?

Anthony Rose
Executive Officer

Well, there's a continuing shift, I think, away from all the star [ph] higher fee-based products to lower. So our Clear Path mortgage product is a lower-fee product than the older package products that we'd had historically. So there is an element of that train that continues to come through. And as we've called out industry-wide, I think customer preferences towards low-fee transaction accounts has also been prevalent. The equipment realizations piece has certainly helped shelter our overall non-interest income performance over the period. How long that continues at that level? Again, what we've seen and what we have evidence this period is a bit of a shift between net interest income and non-interest income. And if that was to turn back the other way, we probably expect to see a similar reversion in the net interest income line. We've talked about some of the other items that are in there. But in -- the change in strategy, the BOQ Specialist had other with the on-balance sheet strategy as well that was obviously a headwind during the period. And interchange fees, I think, has also being called out quite consistently across the sector.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

But that's not a headwind going forward though, the interchange fees or the...

Anthony Rose
Executive Officer

No. So you're asking a question around -- again, I think that just the general trend of reduction, we think the -- and we talked about trading income probably in this period a little bit higher than for the half. It's probably a little bit higher than what we'd expect. I think consistently repeatable is the words we've been using in the past. And yes, you do get some natural growth in the balance sheet, but I think the guidance we've given is our best guesses of the moving parts as we sit here today.

Jon Earle Sutton
Former MD, CEO & Executive Director

I think, Ed, you've also got to look at what's generally happening in the industry, and we're very attuned to what customers want as well. And bundled package products are probably sort of on the way out, whereas people are looking for very transparent products with low fees. And that's why we actually introduced the economized home loan, which is really important for us. So it doesn't have the same features as what Clear Path does. Clear Path's a very good product, but the economizer product actually is -- gives a relatively low rate. The acquisition NIM on that is higher than what we've had in the past for other introductory products. But again, it just balances that out. But the industry itself is looking for greater transparency in its banking products.

Edmund Anthony Biddulph Henning
CLSA Limited, Research Division

And just while I've got the mic, I might steal another question. Just on your provisioning coverage, obviously, you had a good result during the period but your collective provisioning coverage kind of fell, whether you're looking at loans, whether you look at risk-weighted assets. Can you just run through, obviously, how comfortable -- you are clearly comfortable with it, but what's going on there?

Anthony Rose
Executive Officer

So the key driver of the movement in collective provision in the half was really the success that the credit and the workout teams had around moving out of the organization a number of troublesome watch list accounts and had some really good success in that space. I mean, that is certainly helped by the property markets and those things that customers can look at de-leveraging an asset sale to do so with some degree of success. But that's really been the major driver. That's been fundamental improvement in quality of book.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

Richard?

Richard E. Wiles
Morgan Stanley, Research Division

Richard Wiles, Morgan Stanley. I've got a couple of questions. First one is on credit quality and the second one is on expenses. On Slide 22, the loan impairment expense by product shows that there was a huge improvement in Commercial in the half, which was a key driver of the group loan-loss charge falling. The new impaired asset chart below it shows that you didn't have any single name problems, with no exposures over $5 million in the new impaired bucket. But the exposures below $5 million went from around $60 million in the previous 2 halves to $80 million. What does that tell us about sort of broad credit quality trends for the SME segment? It would suggest that things have actually got a little bit worse rather than better.

Jon Earle Sutton
Former MD, CEO & Executive Director

It's a -- you've got to look at it almost by region or geography. And some of the indicators that we actually see come through our equipment financing book, which is just a wonderful portal to you know what's actually happening in the SME world, because largely that book is wheels and motorbikes and small business equipment to support businesses. The way I would look at it, and it -- and with the downturn in mining investment in a lot of Western Australia and also in far North Queensland, some of that -- it's like throwing a stone into the pond. That ripple is starting to spread out a little bit to companies that we're servicing, say, mining-related towns. So for example, if you owned a fleet of trucks that were driving up and down the highway from Brisbane up into far North Queensland, you -- we're starting to see some of those smaller businesses that may have lost some contracts, and they would start to go into impaired. For us, reiterate again, we don't have any big single-name exposures to mining companies or mining-related regions. The book is quite diverse across the regions. For example, in -- on the retail side, when Queensland Nickel shut down, we actually had a team up there really, really quickly to make sure that we had hardship available for those people affected by that shut down. And certainly, those mining-related towns are seeing -- are struggling. But they've also got a lot of resilience as well. And it will take a while for that to transition through. So I think, those small firms, they're relying on that lot of investment, we'll do it tougher.

Richard E. Wiles
Morgan Stanley, Research Division

Okay. And my second question is on expenses. You've guided to 1% underlying cost growth for next year, but you've also said that the Virgin cost will be higher, around $9 million, amortization will be higher. That looks like it might be a similar increase. So what you're telling us is that outside of the Virgin and amortization cost increases, you expect your underlying cost to be down 3%, 4%, 5%, something like that for 2017. Is that correct?

Anthony Rose
Executive Officer

So the normal inflationary impacts, if you like, in the various elements of our expense base that are effectively indebted, the -- we talked quite a bit today about the efficiency program, and I think when we launched that $15 million in February, we did make it very clear that, that was meant to be a catalyst to kick the organization into a mindset of continuous improvement and reinvestment in efficiency and productivity. And I think that as we sit here today, we have -- we had optimism 6 months ago. We've got a lot more confidence about the actual plans that we've got in place to deliver on those efficiency objectives. I think as we have also said in the past, we are coming from further back in --

from a capability perspective compared to some of our competitors, and we're really treading a path that other institutions have already trodden before us. So we're not breaking new ground in a lot of sense in achieving some of the things that we're looking at doing. And I think -- so there will be those benefits that come through that help to shelter the underlying inflationary impacts in the cost base.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

Andrew, I think, had a question.

Andrew Triggs
Deutsche Bank AG, Research Division

Andrew Triggs from Deutsche. Just a question on the broker channel. Just trying to get a sense, Anthony, or -- in respect of how long you think a return to growth is likely to take? If we look at both of the chart you provided in the pack, but also the AFG Competition Index that shows little improvement in the recent months. And also, how you sort of propose to manage the Virgin Money and BOQ brands in that same channel? Will you prioritize the...

Jon Earle Sutton
Former MD, CEO & Executive Director

No, we're brand agnostic and that will be driven by consumers. And the one thing I'll say that the Virgin brand is, it attracts a materially different customer base to what the BOQ brand does. So that will complement over time. And Virgin has had really strong growth in its credit card portfolio and its insurance sales. Now -- we've now got the loan -- home loan out, and will be in the 2 biggest aggregators very shortly. In terms of the brokers, prior to 2013, we were 0 in the brokers, and we're starting to see between 15% and 19% of our home loan volumes come through the brokers. In this start to the new financial year, we've certainly seen increased activity levels over and above where we were in the second half, particularly with our spring campaign. And I would expect that over the coming years, that we'll continue to see growth through the broker channel. Now we have to make sure that we've got the right sort of products, got the right processes to service the brokers. We're doing a lot of work on that. Part of our cost efficiency is to actually get to one back office and to automate a lot of that process as well, which we're doing. But over time, we'll continue to see growth there.

Andrew Triggs
Deutsche Bank AG, Research Division

Do you think you damaged the reputation in the broker channel by sort of growing too quickly and not being capable of dealing with the high demand that you had?

Jon Earle Sutton
Former MD, CEO & Executive Director

Look, we've got great acceptance from the broker channel. And obviously, there are always lessons learned. And we're working very hard with the brokers that we deal with. They've supported us very well over the last few years, and will continue to do so. We need to make sure that our products are competitive. Our turnaround times to "yes" is industry best -- is industry practice. With the new -- our new RLO system, lending -- retail lending system, coming onboard, we'll be able to service our brokers, our Owner-Managers, our corporate branches, and give them the time to "yes" that they all want.

Anthony Rose
Executive Officer

I think the other dynamic on that chart that I showed does demonstrate that we really -- we're unable to match the market as -- where the market was really up until there were movements in August. So some back book repricing and some front book retracement. We're a lot more comfortable now that we're in the market and on the consideration set. And as Jon said, we haven't -- we focused on the plumbing during this period and when all those things come together, we do think we're going to get better momentum, certainly, than we achieved in this half.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

Are there any other questions in the room? Just here in the front.

Andrei Stadnik
Morgan Stanley, Research Division

It's Andrei Stadnik from Morgan Stanley. Just a question on deposit pricing. We noticed that during the second half of '16, BOQ was very aggressive on deposit pricing; for example, on 90-day term deposits, the kind of rates were maybe around 60 basis points ahead of the majors. But that's come back now to be much lower levels, maybe only 10 to 20 basis points ahead of the majors. So what kind of margin benefits could we see if this is sustained into FY '17? And secondly, how will the Virgin Money deposit product launch affect your pricing position?

Jon Earle Sutton
Former MD, CEO & Executive Director

First of all, I'm not going to flag to my competitors what we're going to launch for Virgin Money, so you'll just have to wait and see. And again, it will be an innovative product. It won't necessarily be a term deposit product; be a transaction account. Secondly, it is very difficult to forecast what the NIM impact would be on term deposit pricing. Markets move virtually week by week, and we've seen a significant fall in term deposit pricing over parts of the curve, particularly in the 12-month curve, in the last few weeks. We have adjusted our rates. We'll continue to adjust and optimize the rates that match for our asset growth. But more importantly, as I said, to fight for every basis point in net interest margin on that side of the balance sheet.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

And we've got another question, Mary, to your left.

Brett Le Mesurier

Brett Le Mesurier from Velocity Trade. A couple of questions. Where are you on your net stable funding ratio at the moment? I think the last time, you said something you're around 100%?

Anthony Rose
Executive Officer

Yes. So obviously, the -- it's yet to finalize itself definitively. We did get some additional guidance out of APRA on some interpretations over the last 2 or 3 weeks. So we're still a little above probably where we set last time based upon those new interpretations. There's a broader discussion that needs to play out around the acceptable capital -- the acceptable buffers that then apply to over and above that 100% minimum, and we're waiting to see. We're circa-105% area.

Brett Le Mesurier

You can't make a guess as to what the buffer might need to be?

Anthony Rose
Executive Officer

Well, what I would say is that in liquidity, we've been running around the 120%, 125% level, so 20%, 25% buffer. That liquidity ratio, quite deliberately, moves with some volatility if you make even small changes in your overall liquidity and balance sheet management position, whereas the net stable funding ratio is intended to be a much slower directional move, and we would expect much lower buffer requirements than exist on the liquidity framework.

Brett Le Mesurier

It would be fit -- you mentioned that your loan growth was fully funded by deposit growth this year. You would expect that to be the case for 2017 financial year as well?

Jon Earle Sutton
Former MD, CEO & Executive Director

Look, the opportunity for us in loan growth is quite large. We've got a diverse set of businesses. For example, we've got many thousands of customers in BOQ Finance that we've really tapped into other than just with one product for the leasing. BOQ Specialist has been a wonderful acquisition for us and a wonderful business. Not only does it drive our asset growth in the home loan space, and also significant growth in the commercial space for doctors and dentists. It is also a great vein of deposits as well, which we'll continue to work with to offer deposit products through that business as well. And across the BOQ growth, as Anthony mentioned today, we saw a significant growth, $320-odd million, in your current accounts, which is -- in banking is gold. And we'll continue that as well.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

We might just take one more call from the room before we go to the phones.

Brett Le Mesurier

Can I ask one more question?

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

Can we just take one -- we've got a couple of calls, and we can come back to you, if that's okay?

David Ellis
Morningstar Inc., Research Division

David Ellis from Morningstar Equity Research. I've got a couple of questions on the dividend. The cash EPS fell 2%, yet the dividend increased 3%. So what's the rationale behind that? And does BOQ have a published dividend payout target range? And thirdly, what's the long-term historical average payout ratio for the bank?

Jon Earle Sutton
Former MD, CEO & Executive Director

So I'll make a couple of comments about the dividend. First thing I will draw your attention to is our strong capital position at 9%, and we -- Tier 1. We actually grew that over the year. Also, in the past, we've given some guidance around dividend growth should mirror EPS growth. And over the last few years, we've grown our dividends but also our EPS. We're quite comfortable with what was declared for the second half and for the full year in relation to those 2 aspects. And I'll hand over to Anthony, if you want to make an additional comment.

Anthony Rose
Executive Officer

I think the point is the board takes a medium-term time horizon in setting the dividend profile. And so, yes, we'll be looking to a medium-term future. At a specific level, the actual statutory payout ratio actually reduced this period. So in a true capital generation sense, that -- we didn't have a contraction in capital generated. So it was in line with that statutory piece. Obviously, there's a combination of factors that we look at in that determination. We're very comfortable with that profile. It has remained flat at that level for the last 3 half-year periods, which does reflect the earnings growth profile that we have -- have had in the business over that period.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

Okay, we might go to the phones now.

Operator

Your first question comes from the line of Craig Williams from Citi.

Craig Anthony Williams
Citigroup Inc, Research Division

I have a couple of questions as well, if I may, please. With respect to cost performance, that was perhaps a little disappointing element of this result. In second half '16, I think it was about 5%, excluding restructuring on pcp and 8%, including restructuring on the pcp period. And you've indicated that your payback [indiscernible] come through [indiscernible] the plan in terms of the restructuring initiatives that you -- under talks. And whilst I'm certainly encouraged by the message on costs for FY '17, can you flesh out why you have confidence on execution and why -- with what you've done so far, that you do have confidence in terms of what you can do on costs for the coming year? And how far have you actually already reaped the cost savings from the restructuring you've invested in, in FY '16 given that 100% payback expectation that you flagged in February? And the second question, I'll leave, perhaps until after you respond.

Jon Earle Sutton
Former MD, CEO & Executive Director

Craig, it's Jon here. I'll make some general comments about costs and why we're confident. And if you remember back a few halves ago, I said that some of the technology we employed at the bank was cutting edge in fax machines and couriers. And I'm really pleased to say that we've reduced the number of fax machines and couriers. I know -- but in reality, what we are absolutely doing is moving at pace with check digitization, with fee statements, with moving towards one mortgage hub. We actually have probably 3 different ways of processing mortgages. We're moving to one mortgage hub. Let me give you another example of why we are confident about getting those costs savings. Previously, in banks, when you wanted to do something, you would have to actually hardwire or re-plumb parts of your banking system. We actually employed a number of people to re-key data into disparate systems to actually process a mortgage. We've just employed 3 robots that cost $6,000 each. They've taken the re-key time from 45 minutes to 6 minutes with 100% accuracy. So it's these incremental measures that we're actually taking throughout the business, and with a significant change, rather than from doing large-scale projects, which require large-scale re-plumbing of systems and architecture, to actually using cutting-edge technology such as robots. We have a number of other initiatives underway that will continue to try and take the cost out of the place and reduce our fax machines and stop toll being our #1 -- us being #1 customer for toll, which we're doing.

Craig Anthony Williams
Citigroup Inc, Research Division

Okay. And I think you called out that banks have recently sort of pulled back a little bit on their 12-month term deposit pricing in the last couple of weeks, which tends to indicate that the benefits of deposit customers in balancing stakeholder needs was pretty transitory, the banks have been calling out with the latest round of mortgage repricing. So I'd argue that the industry is perhaps at risk of further government intervention through these sorts of practices. So how much capacity do you think banks have now to continue to rely on mortgage repricing as a tool for driving revenue as there appears to be a breakdown in trust with the public there?

Jon Earle Sutton
Former MD, CEO & Executive Director

So Craig, as you would well know and everyone in the room, that it's impossible for me to make any comment about what we would do or will do with mortgage repricing. What I will say though is that the industry itself, if you start at the very basics, this country has been importing capital from the day it started in the 1800s. Our self-saving ratios for all the banks are sitting between 65% and 68%. And if you look at where we are now with the official cash rate and the low interest rate environment, it is a conundrum for the industry in how it will fund itself going forward. So you actually need to absolutely maintain strength in banks because we rely so heavily on offshore capital. And I'm sure that the industry, over time, we'll work through the various dynamics of both the asset and the liability side of pricing. And from BOQ's perspective, we've been 145 years around and we'll remain competitive, and we'll continue to offer competitive products to our customers, but also watching where our margins are. And it is difficult operating a bank in a low interest rate environment.

Operator

Your next question comes from the line of David Spotswood from Shaw and Partners.

David Spotswood
Shaw and Partners Limited, Research Division

Well done on the cost guidance and the de-risking of the book. Just on, obviously, the margins, one of the key drivers to the revenue and the profitability of the company, and you've given some slides there, you're saying front book, back book minus 5 basis points in the second half; low interest rates, 4 basis points; maybe hedging is 0; and maybe a bit of TDs, so you're sort of 10 basis points funding pressure. But you kept 13 basis points over the last 25 rate cut and you've stopped the heavy discounting on the Clear Path product. So in the second half, NIM was 190. You then, you sort of have comments on the exit NIM or as we sit here today, is it reasonable to assume that margins, and you're focusing on margins 2 to 3 basis points off that 190 as a reasonable estimate going into 2016 and '17? That's the sort of first question. And the second question, if you look at the APRA data, the loan growth in the second half of 0.6, but the fourth quarter was negative, like it fell for every month. So would 2% to 3% loan growth in 2016 and '17 be a good outcome?

Jon Earle Sutton
Former MD, CEO & Executive Director

I'll deal with the loan growth and Anthony can talk to the NIM questions. Again, I'm very heartened by what we're seeing that we're a month into the new year. We're into our spring campaign. We've got great momentum in BOQ Specialist. That business -- we've put $1.5 billion worth of mortgages on the book last year. Its asset growth in the Commercial book is 13%. In the Business Banking world, particularly in our specialist -- in the niche business that we've got, there, again, growing above market. On the mortgage front, we're back in consideration with the brokers across the broker network. And Virgin Money, I believe, will make a material contribution to the group over time. In a very, very short period of time, we've had $100 million worth of applications for the Virgin Money Home Loan. And when I look at like-for-like, in terms of where BOQ was with its -- in terms of its first offering to the brokers and to where BOQ -- to where Virgin is, there's a significant outperformance by Virgin in these early days yet. It's only early days, I'd caution on that. But I believe that with the varied distribution channels and brands that we have, we are well-positioned for growth, which actually gives us great optionality across the group as well.

Anthony Rose
Executive Officer

Just to -- maybe just to follow on that one very quickly, David. I did call out earlier that it really wasn't until August and the RBA rate movement and the market's reaction -- the industry's reaction to that, where we believe we were back at a position where we could compete in the mortgage space. We just simply weren't able to, we believe, deliver appropriate risk return with the pricing point that was in the market, and that was evident in the broker space. So again, I think our confidence that we're at the right price point. It obviously takes time to build the pipeline of that to come through into settlements. So we do expect a bit of a lag there. As far as the margin is concerned, we're not going to give, as we've said, any clear guidance because there are so many moving parts. And then just decomposing some of the items that we called out on the margin chart, the repricing steps that had been taken to date in the portfolio, which are public, probably generate in the order of 7 basis points into the next half. Now there's been this front-to-back book pricing dynamic, which -- with a few other moving parts, were, in aggregate, 5 basis points last half. I think you would expect that there will be some element of degradation out of that line, whether it's to what extent, again, we would expect some degradation. The hedging costs, we would hope that, if market conditions prevail as they are, that will be flat. Capital and low-cost deposits is effectively locked in as a 4 basis point degradation in the next half. So really, it comes down to where that funding cost to mix line lands. And that's the one that's inherently open to the dynamics of the yield curve and the dynamics of the industry's response to how all of that plays out. So that's the best sort of steer we can give you on all the moving parts.

Operator

Your next question comes from the line of Ashley Dalziell from Goldman Sachs.

Ashley Dalziell
Goldman Sachs Group Inc., Research Division

Just picking up from the last question. I suppose I've seen in the last couple of months term wholesale funding spreads actually tighten in by a little. Can I just ask if you're seeing the same sort of trend within the domestic short-term wholesale segments that you play in? And secondly, just around the capital and low-cost deposits and the replicating portfolio there, and you flagged that, that 4 bps headwind is probably locked in for the first half of '17. If we assume essentially a flat yield curve from here, would you assume there a similar headwind in the second half of '17 as well?

Anthony Rose
Executive Officer

So I'll take the second part of that question first. The answer to that is yes, directionally, that type of profile going forward. As far as the term wholesale funding spreads, there has been a retracement from the widest spread over recent periods maybe in the order of 20 basis points sort of across elements of the curve. And it does appear that those markets are arguably operating more effectively than they had been previously. We're also seeing some improvement in the RMBS market, and it's getting close to, if not already there, at levels where you could probably complete a capital relief transaction. So I think we're reasonably comfortable with the forward outlook for our issuance over the period. As far as the whole sale spreads are concerned and middle market, they're still pretty stubbornly wide, I would say. In fact, if you look at the curve, there is a really interesting kink at the 6-month part of the curve. It's about 25 basis points wider than all other elements. And I think what you're finding there is everybody's shifting that wholesale space out to the 6- to 12-month bucket, where it used operate in the 90 to 180 days. And that kink in the curve, I think, does demonstrate there is some market-based pressures that are at play in that space at the moment. So we're watching it closely, but at this stage, don't seem to see any relief on that side.

Ashley Dalziell
Goldman Sachs Group Inc., Research Division

Okay. And just if I could follow-up my question I suppose on the branch network and expenses. You've sort of closed down another 13 in the half, about 23 for the year. Are you sort of largely through that footprint rationalization now? And can I also ask just for a bit of an update on the RMB channel, how many of those guys you have on the new scorecard and how that's been going through the half?

Jon Earle Sutton
Former MD, CEO & Executive Director

Yes, look, we're very excited about the new scorecard. We've got close to...

Anthony Rose
Executive Officer

48%.

Jon Earle Sutton
Former MD, CEO & Executive Director

48% now on the new scorecard. And that is driving significant uplifted outcomes for us, particularly on the risk management side. We've had a great uplift in all of our branch audits across the branch. All of our Owner-Managers are incented on a balanced scorecard in terms of deposit gathering, customer service, asset growth and actually serving the whole of the customer needs. And we would expect that to, again, increase in the number over the next couple of years to get to around the 80% mark for the balanced scorecard. In terms of branch numbers and branch network, I've talked about this in the past, is you just can't just necessarily focus on branch numbers. You've got to really focus on distribution channels and how and when customers want to deal with a financial institution. And for us, we've been configuring that network. We've seen a number of Owner-Managers retire. We've seen a number of Owner-Managers buy into additional branches, and we've also closed a number of those branches because they're actually not in great locations or the demographic is not right. Also, what we don't talk about a lot is we have a small online digital channel. It's grown about $100 million in mortgages over the last 12 months. And then if you look at what we're doing with Virgin and the brokerage coverage you have, we're very comfortable with the distribution footprint. Distribution footprints will change as digitization rapidly expand across the finance sector over time.

Operator

Your last question comes from the line of Victor German from Macquarie Bank.

Victor German
Macquarie Research

I also had just a couple of questions which I wanted to ask. The first one is a pretty simple one. Just throughout the presentation, we referred to underlying expenses. Would it be fair to assume that underlying expenses this -- in FY '17 should be in line with reported expenses? Or is there anything else that we need to keep in mind on the expenses side?

Anthony Rose
Executive Officer

So we've said underlying expenses are $505 million, and we've given guidance at 1% growth on that number.

Victor German
Macquarie Research

No, I appreciate that. But what I'm saying is, in earlier periods, we've had some additional expenses on top of underlying. There is nothing that should be coming through this period, is there?

Jon Earle Sutton
Former MD, CEO & Executive Director

We're very clear on the guidance we've given on costs, 1%.

Victor German
Macquarie Research

Okay. Okay, so the second question I had was -- is following up on earlier discussion around deposits. And it's quite difficult to work out exactly what's driving sort of deposit margin movements because different banks treat sort of hedging costs differently and things like that. Following from maybe what Jon has asked earlier, are you able to give us a sense of what has resulted in that margin pressure on your deposit book? We haven't really seen sort of similar commentary from your peers. I've noticed that your deposit mix has shifted a little bit towards more term deposits away from saving deposits. Perhaps that was one of the drivers. But just maybe if you could provide a little bit of color as to what's driving more sort of deposit pressure for you guys relative to what we've seen with your competitors?

Jon Earle Sutton
Former MD, CEO & Executive Director

I can't possibly make any comment on what our competitors have been doing. But certainly, when you saw those elevated 12-month rates, which were led by some of the big 4, that certainly costs the industry. Now those deposit rates have come down. But also, I just want to point out, we're running the bank here for the long term and not for the short term. And if you think about liquidity and liquidity risk and where banks are, having a deposit base and term deposit base that we actually had is a very, very good thing over the long term. I'd also point you back to the earlier comments that we actually made. We have seen $320 million worth of growth. I know it doesn't sound like a lot, but it's meaningful to us, BOQ, as a smaller niche player in our current accounts. So we're actually putting more current accounts on, opening up more accounts for people to put -- deposit their pay in, week in, week out. And that's a slow burn, and we will continue to do that. But we'll also respond to what we see as the competitive pressures across the TD market. And a lot of what we're seeing at the moment is because we're operating in an ultra-low interest-rate environment, and we're all adapting to that environment. But I remain confident that our deposit growth, the opportunities for further deposit growth against the various businesses and business lines we have will see us in good stead over the medium term.

Victor German
Macquarie Research

No, I mean, I completely appreciate the point around deposits and how important they are. Traditionally, your deposit pricing has been above -- generally above market. As interest rates are coming down, do you think there is need for you to maintain that premium to the market in order to be able to attract deposits?

Jon Earle Sutton
Former MD, CEO & Executive Director

As I said in the past -- during the presentation, we're doing a lot of work on data analytics to absolutely ensure that we have the right sort of -- the right pricing for the mix that we have for our asset growth. We don't just -- we actually put it all into the -- we've all put it into our thinking around what is the right asset mix that we actually want, the right asset growth we want, how do we fund it in terms of also where our dividend will be. So rest assured that we are doing everything to ensure that we actually have the right sort of deposit pricing for the asset growth that we actually want managing both sides of the balance sheet in what is a very low interest-rate environment.

Victor German
Macquarie Research

And the last point I just wanted to -- with the retail system that you've been investing in, when do you expect that project to be completed? And do you expect that to result in better volume growth from the broker channel without necessarily needing to lead by price?

Jon Earle Sutton
Former MD, CEO & Executive Director

Yes, look, we've had that system up and operating for a number of our loan products. And our time to "yes" has just materially improved. We've gone from -- in the early days, we didn't know when the home loan hit the branch. To now, where our branch people can actually give an unconditional yes if we can tick all the boxes on the same day. We're now taking that right through the rest of the products we offer. We'll never get to 100% of all products because some of the products or some of the lines can be quite complex. We'll finish that work towards the end of this year and early next year. And yes, we do expect better outcomes, not just for our brokers, but for our branches and our Owner-Managers as well.

Anthony Rose
Executive Officer

I think as an organization, we've actually done a lot of heavy lifting over the last 12 months on that retail lending origination program, on the Commercial lending origination environment that Jon called out earlier, which effectively does the same thing in digitizing our small business and Commercial pipeline. And we've also launched the Virgin Money mortgage product. A lot of the benefits of those programs are not going to be evident in the economics of our results in this period. They are foundational for longer-term -- medium and longer-term growth profile.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations

I might just give Brett the opportunity in the room to ask that question that he wanted to ask before we wrap up. This is the last question.

Brett Le Mesurier

I was interested in the difference in the loan margins that you had between Commercial lending and residential lending. You just put an average in there. And since you are growing Commercial lending and you weren't growing residential lending, I was wondering what the benefit was that we could look forward to?

Jon Earle Sutton
Former MD, CEO & Executive Director

We're not going to disclose exactly what that benefit is. But if I can just talk about the lines of business that we actually have. If you look at BOQ Finance, it is a higher-margin business, and there are elements within that, that are very good for us. I'll just draw your attention to the sorts of lines of business that we do there. For example, we stand behind one of the largest global PC makers. And again, that's a great business to be in from a margin perspective. We also stand behind a number of motorcycles, and we've had a 10-year relationship with Honda motorcycles. So if anyone wants a motorbike, I'm sure we could help you. But again, that's a high-margin business. If I look to some of the comments that Anthony made earlier, particularly in the commercial lending space, we've actually seen a moderation in the competition as rates have moved. Again, for us, it's looking at also the ancillary services that we actually have there as well. And if you look at BOQ Specialist serving the needs of the doctors and dentists in that professional segment, it's not only just the home loan, it's also the practice financing, it's also the specialized equipment financing that goes with that. And again, that's why we're very confident about the outlook of the longer-term for us -- for our goal on EPS outperformances, that we are very focused on these strategic niche markets. We don't want to be all things to all people. We don't want to be a mini-me of a big 4 bank, and that's why -- that's the pleasing aspect, is the progress that we've actually made against our strategic objectives.

Tanny Mangos
General Manager of Corporate Affairs & Investor Relations
Well, that brings an end to the briefing. Thank you so much for joining us, and there'll be some light refreshments as well on your way out. Thank you.