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Chairman's Address
2018 Annual General Meeting

2018 was another solid year for BOQ against the backdrop of a very difficult operating environment. Overall however, our financial results were robust and continue to demonstrate that our strategy is appropriate for the environment and is delivering results for shareholders:

- The cash earnings result of $372 million was two per cent lower than 2017, but increased three per cent after excluding the $16 million profit on disposal of a vendor finance entity which occurred in 2017.
- Total income increased two per cent on an adjusted basis to $1.11 billion, supported by three per cent growth in lending assets and a five basis point improvement in net interest margin.
- Operating expenses were well contained and loan impairment expense reduced 15 per cent.
- Cash earnings per share were one per cent higher than 2017 on an adjusted basis and the ordinary dividend maintained at 76 cents per share.

Despite these relatively good results, total shareholder return for the year was negative 2.7 per cent, reflecting the operating environment for the sector as a whole. Indeed, in reviewing the 2018 financial year, there is perhaps no word better to describe it than challenging…challenging for the industry, challenging for the Bank and challenging for bankers both personally and professionally with numerous headwinds, including slowing credit growth, increased funding costs, intense competition for new business, and the increased cost of technology and digitisation initiatives. Intense regulatory and public scrutiny of course, has also culminated in the Royal Commission, which has only further diminished public confidence and trust in the financial sector.

Given this environment, management's achievements for the year are solid. But it was the stories behind the headline numbers that are perhaps most deserving of further commentary and praise for our executive team.

For the Board, five achievements stand out.

- First, was the five basis point increase in the all-important net interest margin for the year, to 1.98 per cent;
- Second, was restoration of growth in our housing book, with housing loans up $653 million for the year and total assets up 3 per cent year on year in a slowing market;
- Third was the continued expansion of Virgin Money Australia, BOQ Specialist and our other niche commercial lending segments, which are our key growth levers for the future;

- Fourth, was the continued strength in asset quality across the Bank with arrears low and steady across all portfolios and loan impairment expense at just nine basis points of gross loans, or $41 million; and
- Finally, I should highlight the four per cent growth in customer deposits in a highly competitive market, taking our deposit to loan ratio to 69 per cent.

Clearly, challenges remain for the Bank going forward, especially given the broader macroeconomic and socio political environment. We do however remain confident that our strategy to focus on niche segments, being customer focused, and diversifying across geographies, channels and markets in order to facilitate low risk growth, is delivering results. Indeed, it is this relatively simplified, strategic framework that has helped transform BOQ from a solely branch-focused distributor of home loans to a much more diversified business with multiple brands and channels for distribution and a specialist business bank, which now contributes nearly 60 per cent of Group earnings. This success with our business bank is in large part to our rapidly growing medical finance business in BOQ Specialist and the growth in our leasing and structured finance at BOQ Finance.

Fundamental to delivering future growth is the continued digitisation and ongoing investment in innovation. Given the Bank's strong capital position, your Board and Executive Team are now well positioned to continue to explore options to invest in new applications, business models and services to improve the banking experience for our customer base. At the heart of this digital journey is the Virgin Money Australia business which is increasingly providing us with new avenues for growth by appealing to a different customer demographic.

Of course, performance is about much more than just growth options and financial results. It's about how we respond to our operating environment and how we ensure that we are doing the right thing for our customers and the communities in which they live and work. It's about context and so today I would like to focus on just some of the other C's of the contemporary banking lexicon that are critical for us to deliver on if we are to meet the expectations of shareholders, customers, and the broader community.

These are customer, conduct and culture, credit and competitive neutrality.

First to customers. With the total customer base of almost one million, we are today a broad based financial services company operating nationally with clients spread across all states, multiple business lines as well as multiple industries. Our focus is on delivering a superior offering to those customers, regardless of the medium with which we interact with them. Anywhere, anyhow, anytime must be our mantra and fundamental to this, is the digitisation of the Bank, better product offerings and fees, and a platform that offers seamless and timely access to bank services.

Our progress here has been good, although we still have a long way to go. Robotics, artificial intelligence and big data are being explored as we streamline our systems and move to a more modern and nimble cloud environment. We are also investing in new enablement platforms across our brands with a successful rollout already completed for our new Virgin credit card mobile app and our digital FX offering for our corporate and SME customers planned for launch in 2019. A partnership with Square, a payments platform, now offers SME customers a state of the art digital front-end for payments. Planned roll-outs in transaction banking should enable our Virgin Money Australia customers to enjoy a fully digital banking offering, whilst a new digital web front end in our traditional bank should modernise our customer interface across our core banking client base.

Success on all these fronts, especially in mobile banking, should enable us to provide better digital offerings and therefore superior services to our customers. It will also help us deliver on our promise to help create new experiences, solutions and growth opportunities for our customers whilst delivering smarter and more efficient ways of transacting. This can only further build customer affinity and satisfaction.

But serving the customer is about more than making things easy for the customer, it's also about ensuring that we do the right thing all the time. It's about culture and conduct which are the key issues dominating the media today. Prompted by the Royal Commission and the distressing stories arising from some of the evidence given, the spotlight has now well and truly been directed towards the sector's conduct, its social license to operate and community trust.

For those of you following the Royal Commission, there can be no doubt that regardless of how good a company's financial results may be, sound financials based on poor culture and conduct is not a sustainable business model. The findings from the Royal Commission's Interim Report made for sobering reading, with examples of industry wide misconduct including irresponsible lending, conflicted remuneration, poor remediation processes and poor culture. These are phenomena that the Royal Commission has relentlessly focused on with damaging results and inevitably heavy penalties. Although BOQ has not featured prominently, we are a bank and damage to the banking sector colours us all.

We too must learn from the industry's failings, adapt to the new "normal" in terms of community standards, and also learn from our own mistakes whilst making every effort to help ensure trust is again enshrined in the sector and in particular in this Bank. I can assure you that management is making every effort to review our culture and way of doing business so as to ensure that our conduct and behaviour is aligned with community standards.

So what does this mean for BOQ?

Certainly, it means a relentless focus on the customer and on strengthening processes that are best practice when viewed in terms of returning trust and faith in the industry. It also means ensuring across the Bank that we do the right thing for our customers at all times and that we endeavour to ensure that where needed, there is more fairness and accountability across the Bank whether it be in transacting, responding to issues, dealing with hardship or handling complaints more effectively. It's about restoring trust and doing better than average because no one is perfect and we can all learn and improve the way we deal with customers.

The good news is that many of the programs designed to meet these high standards of behaviour are already being rolled out across the Bank.

We already have a solid ethical framework and are currently reviewing our hardship processes and the depth of our complaints reporting. We are also increasing reporting to the Board and have an organisation and reward structure that emphasises the customer and the importance of ensuring that we always do the right thing. We believe strongly in the "show me, not tell me" principle of governance, and insist on a strong and engaged Board to help drive change. Finally, we have already strengthened the independence and powers delivered to the customer advocate at the Bank to deal with client issues and complaints and now seek more granularity when reviewing complaints, hardships and service issues at

Board, so we can better understand the systemic and behavioural issues that may exist in our business.

Unfortunately, the “not so good news” coming out of the Royal Commission is that faith in the industry, in our collective corporate purpose and social license, has been well and truly tarnished and arguably, justifiably so. We are not immune from these adverse industry factors, but changing the community’s perception is a much more difficult task than just remediating your own issues, as an ebbing tide carries all before it, regardless of how well you can swim. We must be conscious of this broader challenge, whilst not ignoring the direct impost placed upon BOQ staff to continually change behaviours so as to ensure we are doing the right thing by all our customers, all the time.

Turning now to the third of my Cs, Credit.

Credit for the Bank means loan losses and non-performing assets but, for our customers, our clients, it inevitably means the availability of credit and the state of the housing credit markets.

While credit quality at BOQ is a key strength, Virgin Money Australia and the BOQ Business are growing strongly, the outlook for credit growth is problematic, with housing system credit growth at its lowest level since 2014. This reflects tighter macro prudential regulatory requirements, especially for investors and interest only loans, flat wages growth, possible changes to negative gearing tax legislation, strengthened lending standards and tighter expense and income verification requirements, which we have long been doing unlike some others, often to our disadvantage.

Prices, perhaps not surprisingly, have also moved down reflecting excess apartment supplies in some markets, tighter lending markets and a resultant supply demand imbalance, especially on the East Coast, with national housing prices in October down a further 4.9 per cent year on year, led by Sydney, off 7.4 per cent year on year, Melbourne and Perth. The good news for many of you here in the room and which may finally bring a smile, is that Brisbane prices year on year, are up 0.4 per cent. Whilst some market pundits are calling for a 10 to 15 per cent market correction and a credit squeeze, consensus is still for an ‘orderly correction’ and only a moderate increase in mortgage delinquencies. This is not unreasonable given recent market strength, low unemployment and a strong macro-economic environment, although the flow on consequences to the national economy of a weakness in housing are yet to be felt.

Regardless of how things play out, BOQ is well positioned to navigate this environment given our clearly defined risk appetite, strong capital position and disciplined approach to risk management.

Lastly, a word on competitive neutrality.

When it comes to the application of bank regulation and capital standards across the industry, we simply want a ‘fair go’. Under current prudential settings, we must hold 60 per cent more capital on average for a residential mortgage than the majors. Likewise for the exclusion of many the non-bank financial institutions from the regulatory requirements that we are required to abide by, despite their rapid growth outside the regulatory net. This inequity substantially inhibits our ability not only to grow, but to provide an acceptable return to shareholders and other stakeholders. Whilst we support the need for stability and a strong banking system with appropriate levels of capital, we cannot support an unfair and uncompetitive set of banking regulations which clearly disadvantage regional banks such as BOQ.

Before I hand back to Jon, I would also like to spend a few minutes on a very sensitive issue for the banking sector, namely remuneration. Certainly, your Board is sensitive to the increased profile that bank pay has for all stakeholders and therefore seeks to ensure that financial rewards equitably balance the needs of shareholders and customers whilst continuing to satisfy community expectations. In determining remuneration for the past year, we have also been conscious of the high quality of the BOQ executive team and our view that the interests of shareholders are also best served by adopting remuneration policies and practices that are designed to retain and motivate this team. These trade-offs are always a difficult balancing act, but in 2018 it has seen the Board reduce the amount of short term incentives paid to our senior executives by 20 per cent. This is the lowest aggregate incentive amount paid to our senior management group, including the CEO, in the past five years. In part, this recognises below target scores on key performance metrics as well increased community concern over the quantum of bank remuneration.

In addition to the aforementioned reductions in the amount of STI awards for senior management, further changes have also been made to vesting terms to better align remuneration with community expectations and the Banking Executive Accountability Regime (BEAR) legislation. As a result, executive STI awards will now be deferred for three years instead of two, and LTI awards for four years instead of three.

The BOQ Board has not been immune from our desire to better align remuneration with shareholder and community expectations, with compensation to Directors held flat for the fourth consecutive year. In addition, we have also implemented a requirement that all Directors hold a minimum of one year's base fees as BOQ shares to increase our 'skin in the game' and are introducing a salary sacrifice scheme for Directors to purchase BOQ shares at market. This will further facilitate an increase in their Bank shareholdings.

Efforts are also being made to promptly comply with all the other BEAR and Sedgwick requirements regarding remuneration in the sector, through a thorough review of the Bank's commission structure and the removal of any misaligned or conflicted remuneration or sales commission structures. This is a highly complex and complicated task, but it is being implemented in the manner that you would expect of a bank with a strong ethical framework that puts the customer first.

In closing, I would like to firstly extend a special thank you to all our loyal customers. Thank you for being patient and passionate about your Bank and thank you for setting the standards necessary for us to meet your needs through superior service.

Secondly, I would also like to express my sincere thanks to my Board for your commitment, time, passion and wisdom in helping me steer the organization forward and in particular a word of thanks to our former director Margie Seale who, regrettably retired during the year after several years of generous service. We wish her well in her board career and thank her for her commitment to the Bank. An external search is now underway for her replacement.

A kind word of thanks also, to all the Bank staff and executives without whom there would be no Bank. People do business with people and in delivering the Bank's results, it's critical that we acknowledge the invaluable role all our staff play in managing that customer interface. All the technology in the world can't beat that smiling face and warm words of welcome when you do business with a BOQ banker. Happy staff, happy customer, happy bank as the mantra goes.

Lastly a big thank you to all our shareholders for your support during the year. Your Bank is in good shape, is well capitalised, has great management and a sound strategy to pursue despite the myriad of external challenges we face. We will endure and we will continue to make you proud to be our owners.

I will now hand over to Jon for his CEOs address.

Roger Davis
Chairman